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U.S.-EUROPE: PROSPECTS FOR TRANSATLANTIC ECONOMIC COOPERATION

HEARING

BEFORE THE

COMMITTEE ON INTERNATIONAL RELATIONS HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

DECEMBER 14, 1995

Printed for the use of the Committee on International Relations

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U.S.-EUROPE: PROSPECTS FOR TRANSATLANTIC ECONOMIC COOPERATION

THURSDAY, DECEMBER 14, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, DC.

The committee met, pursuant to call, at 10:38 a.m. in room 2172, Rayburn House Office Building, the Honorable Benjamin A. Gilman, chairman, presiding.

Chairman GILMAN. The committee will now come to order on the hearing. Would the witnesses please come to the witness table?

I take great pleasure in opening the hearing on the prospects of transatlantic economic cooperation with two panels of distinguished witnesses for the Administration and from the private sector.

With Congress focused until almost 1 a.m. this morning on our intervention in Bosnia and our relations with NATO, we should not lose sight of our broader long-term interests throughout Europe.

Our Nation has always been an Atlantic and Pacific power, with the European Union as our largest export market. We have a some $250 billion trade relationship with Europe and a total of some $1 trillion in direct investment. The sheer magnitude of this investment relationship dwarfs that of other regions of the world. There is, in fact, more European investment in Texas than American investment in all of Japan. In 1994 we had more direct investment in the United Kingdom than we did in all of Asia. While our trade deficit is more than $1 trillion, over the past 25 years our trade with Europe has been largely balanced over the same time period.

In short, we need to recognize our strong trade links across the Atlantic, and in so doing we need to acknowledge that our national trade laws and regulations need to keep pace with the expanding scope and pace of global trade in goods and services.

As a follow-up on the Madrid summit, the United States should initiate a call for transatlantic trade talks designed to spur an early resumption of multilateral trade negotiations as well as the implementation of a more comprehensive bilateral trade agenda as outlined by our private sector leaders in Seville in November.

We look forward to hearing from our Administration witnesses on their plans to implement a new trans-Atlantic agenda to meet the challenges of the emerging global trading system.

We have with us today Mr. Daniel Tarullo, who currently serves as Assistant Secretary of State for Economic and Business Affairs, representing the State Department on international trade, finance, and economic matters. In March, President Clinton appointed Mr.

Tarullo as his personal representative to the G–7 Group of Industrial Nations.

In the past, Mr. Tarullo has served as international counsel to the law firm of Sherman and Sterling and has taught international economic regulations, antitrust, and corporations at Harvard Law School.

Welcome, Mr. Tarullo.

We also have with us David Rothkopf, who currently serves as Acting Under Secretary of Commerce for International Trade and leads the U.S. Department of Commerce International Trade Administration.

Prior to his appointment as Acting Under Secretary, Mr. Rothkopf served as Deputy Under Secretary of Commerce for International Trade Policy Development. In November 1994 Mr. Rothkopf was named by the White House to serve as coordinator of U.S. economic policy toward Haiti.

Welcome, Mr. Rothkopf.

We will be hearing later this morning from William Frenzel and Michael Farren in the second panel.

Gentlemen, welcome. You may summarize your statements or read the full statement. The shorter you can make it, the more opportunity we will have for a dialogue.

Mr. Tarullo.

STATEMENT OF THE HONORABLE DANIEL K. TARULLO, ASSISTANT SECRETARY FOR ECONOMIC AND BUSINESS AFFAIRS, U.S. DEPARTMENT OF STATE

Mr. TARULLO. Thank you, Mr. Chairman, and good morning.

I would ask if you could have my prepared statement included for the record. I will try to summarize just by making a couple of points.

Chairman GILMAN. Without objection, your full statement will made part of the record.

Mr. TARULLO. My first point, Mr. Chairman, actually begins from your introductory remarks, which is that our relationship with Europe continues to be a very important one across the spectrum of areas, political, economic, cultural and otherwise.

Indeed, the new Transatlantic Agenda which President Clinton, President Santer, and Prime Minister Gonzalez signed in Madrid a week and a half ago really reflects the success of our postwar relationship with Europe across each of these areas.

The agenda affirms four broad objects for the U.S. partnership with Europe: First, cooperation in promoting peace and stability, democracy, and development around the world; second, our cooperation in responding to new global challenges such as international organized crime, terrorism, and drug trafficking; third, contributing to the expansion of world trade and closer economic relations; and fourth, in building bridges among sectors of our society other than the executive branch of our Government from our legislatures to our business communities, scientists, educators, and others.

I think it is important to emphasize that the New Transatlantic Agenda is not really a new framework for relations with Europe. We do, after all, have very close relations with Europe and the Eu-

ropean Union across all issue areas. What it is, Mr. Chairman, is a program for action, not just another call for consultation and coordination.

We have amplified the objectives of the agenda in a detailed action plan containing over 150 specific items. We have also in the summit declaration drawn from this list to set out some key priorities for action in 1996. I would emphasize the effort to identify priorities on which we will act in the coming year.

The agenda, in my view, is a kind of rolling process which focuses on producing tangible results in the context of twice annual summits between our leaders. It does not create a new bureaucracy or some convoluted new structure. Between summits it will be coordinated by a senior-level group made up of senior representatives from the European Commission, the EU presidency, and the State Department, along with the involvement of senior sub-Cabinet members of USTR, Commerce, and other agencies.

This group is charged with monitoring progress and reporting to the leaders at each summit. It will also identify new initiatives for priority action to take place after that summit. The trade agenda will of course be overseen by USTR.

As you can tell from the declaration by the leaders, we have identified a number of priorities for immediate emphasis from the longer action agenda. Given the interests of this committee this morning, let me identify a couple in the economic area in particular.

Our goal there is to take practical steps that can result in more open markets and bring closer the realization of a New Transatlantic Marketplace which will create good jobs on both sides of the Atlantic. Specific initiatives include a joint study on ways to reduce or eliminate barriers to trade, agreements on mutual recognition of product testing and certification, a new agreement on customs cooperation, and a program to collaborate on regulatory issues to promote the development of a Transatlantic Information Society.

In addition, and again echoing a theme in your introductory remarks, we have identified specific areas for cooperation in advance of the Singapore WTO Ministerial. It is essential that the United States and Europe cooperate on a multilateral level as well as a bilateral level. Our involvement and partnership in producing multilateral initiatives has been key to the success of multilateral trade negotiating rounds since the Kennedy Round in the 1960's.

We have already agreed that we should launch a new negotiating effort to include an Information Technology Agreement in line with the recommendations of our business leaders made in Seville in November.

We have also agreed to seek new, mutually agreed tariff reductions which consider acceleration of other Uruguay Round tariff cuts.

Mr. Chairman, impressive as the program in the New Transatlantic Agenda is, it will only be as good as it is implemented. The President, in Madrid, emphasized the need to move beyond talk to action. In just the week and a half since the summit, we have begun work to implement the initiatives identified in the declaration.

Under Secretary Spero and I have already met with officials of the Italian Government, which assumes the EU Presidency on January 1, to convey our ideas on implementation. Deputy U.S. Trade Representative Jeff Lang is right now in Europe pursuing early initiation of the joint study on reducing trade barriers and making progress on trade elements of the agenda.

Prime Minister Dini of Italy has shown his interest in taking leadership as Italy assumes the EU presidency to implement the priority objectives in the early part of next year.

Internally, we are organizing ourselves for implementation. As I mentioned, we are not creating a new bureaucracy for this purpose, but we are assuring that appropriate agencies are taking responsibility for the priority initiatives and making contact with their European counterparts.

As part of this rolling process, we will remain in close consultation with the business leaders and their staffs who produced the very impressive Transatlantic Business Dialogue in Seville. We welcome the precision of their proposals. We will continue to work closely with them and other interested parties in generating additional priorities to be adopted in coming summits.

In conclusion, Mr. Chairman, the New Transatlantic Agenda remains a work in progress. Its broad goal of recasting and adapting our partnership with Europe in light of the new challenges of the post-cold war world will be achieved only gradually, with inevitable stops and starts.

The agenda is not the sum of our relationships with Europe. It is an important point of departure for concrete initiatives to strengthen these relationships, and it is also a vehicle for developing and implementing new initiatives.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Tarullo appears in the appendix.]

Chairman GILMAN. Thank you, Mr. Tarullo.

Mr. Rothkopf.

STATEMENT OF THE HONORABLE DAVID ROTHKOPF, ACTING UNDER SECRETARY OF COMMERCE, U.S. DEPARTMENT OF COMMERCE

Mr. ROTHKOPF. Thank you, Mr. Chairman.

I too have a longer formal testimony which I hope will be entered into the record and will summarize my remarks.

Chairman GILMAN. Without objection. Please proceed.

Mr. ROTHKOPF. The European Union is simultaneously our most important market and our largest competitor. It is also our most important partner in sustaining the global trading system. I would like to talk a little bit about balancing these various relationships.

Our exports to the EU single market are now at an annual rate of $129 billion, slightly ahead of our exports to Canada and more than twice our exports to Japan, our third largest market. U.S. exports to the EU right now are 18 percent ahead of last year, and our trade balance with the EU in the third quarter has improved at an annual rate of $10 billion above the level of the same period a year ago. With a favorable scenario, U.S. exports to Europe could grow by a further $120 billion the next decade.

While the EU's economy grows modestly in percentage terms, the results are huge dollar increases. Its 3 percent real GDP growth in 1995 is equivalent to a 1-year increase of $220 billion. That is like discovering every year a new market the size of Taiwan, which happens to be our eighth largest export market.

When you take U.S.-EU exports of goods and services to each other and add that with production of U.S. and European companies in each others' markets, annual transatlantic commerce adds up to $1.7 trillion. That is 50 percent larger than transpacific commerce. Moreover, the transatlantic commercial relationship is a balanced relationship. Over the past 25 years, if you cumulate our trade with one another, it nets out to zero in terms of the balance. It is even.

Also, importantly, there are 3 million workers in the United States employed in European companies that are operating here, and there are 3 million European workers employed in U.S. companies operating in Europe.

But that said, it is also important to note that Europe is our largest competitor. The EU's exports are almost one-fifth larger than our own. European exporters are supported with broad government backing—export promotion, advocacy, export credits, and a variety of rules that make it easier for EU companies to compete with our own.

Over the next decade some 150 large-scale capital projects worth nearly a trillion dollars are likely to be undertaken globally. Intense competition among firms and governments providing support to them is expected to follow, and much of that competition will be between U.S. and EU firms.

We must not allow the fact that we are competitors to become the dominant feature of this relationship, for while Europe is important in that capacity, it also has enormous, and, I might add, critical significance as a global partner in opening world markets and in shaping the multinational system. When the United States and the EU decide to work together, change takes place in the world trading system. When they don't, it doesn't. That is why the Commerce Department has played an active role over the past year in a major and highly successful effort to reinvigorate the U.S.-EU relationship.

It was almost a year ago that Secretary Brown proposed a Transatlantic Business Dialogue. The idea was simple. If we wanted to know how to improve transatlantic commerce, we should turn to the business community. And I must say we met an active and enthusiastic response from the business community. Xerox CEO Paul Allaire and Ford CEO Alex Trotman cochaired the U.S. private sector effort, which resulted in the Seville conference to which you referred, which took place on November 10 and 11, 1995.

Half the U.S. CEO's who were participating in this conference were from small and medium-sized firms. The conference itself was a remarkable success. More than 100 U.S. and European business leaders formed a microcosm of a transatlantic business community. They discussed their common problems, and they came together with a common set of specific recommendations laying out a strong trade agenda. I have copies of the report today, and we have also put the text up on the Internet (nttp:llwww.itaiep.doc.gov).

I will identify only a few of the highlights. Most importantly, both business communities saw different standards, product approvals, and regulatory requirements as the largest remaining barriers between our markets. They called for mutual acceptance of standards and product approvals and for the goal of eventual harmonization. They sought to create a joint business-government transatlantic standard certification and regulatory committee. They also agreed that governments should accelerate the Uruguay Round tariff cuts and should negotiate by the end of 1996 an information technology agreement that would eliminate duties on a broad range of high-tech products.

Surprising many people, European executives joined U.S. firms in calling for effective anti-bribery legislation—with sanctions and an end to the tax deductibility of foreign bribes.

The key now is to implement these recommendations. The first step in that process was the Madrid summit. There will also be a follow-up meeting of the executive committee of the Transatlantic Business Dialogue in January. We must work as a government to ensure that this momentum continues. We are very pleased that Ford CEO Alex Trotman and Juergen Strube of BASF have agreed to continue as cochairs of the effort.

I might add, in conclusion, that we are currently working with U.S. and European industry institutions to arrange, as an example of our commitment, an April 1996 conference to explore the harmonization of automobile safety standards, testing, pollution, and noise requirements. The European Parliament is also playing a key role, and we hope for active congressional involvement as well.

Mr. Chairman, I would like to conclude my remarks by stressing that the Transatlantic Dialogue in Seville and the U.S.-EU summit in Madrid provided an excellent vision of the future. Now we must convert that vision into a reality. These hearings today are an important step in that process.

[The prepared statement of Mr. Rothkopf appears in the appendix.]

Chairman GILMAN. I want to thank you both for your very important testimony.

We are going to continue our hearing through the voting. I have asked Mr. Bereuter to go over early and come back so we don't have to delay.

In February 1995, the German Defense Minister Ruehe offered the following comment on our United States-European cooperation, and I quote: "The foundation for transatlantic relations has changed. NATO as the sole institutional basis is no longer sufficient."

I ask my panelists, do you agree with this perspective and, if so what would be an appropriate institutional basis?

Mr. TARULLO. Mr. Chairman, I am not sure from the excerpt that you read from that speech whether the minister was referring to security relationships alone or to the breadth of——

Chairman GILMAN. He was referring to U.S.-European cooperation.

Mr. TARULLO. In general, I see.

I think that one of the presuppositions of the New Transatlantic Agenda is that we have substantial links and relationships already.

In the security area obviously, NATO and more recently OSCE provide the foundation for our joint activities. In the economic area, as you and David Rothkopf and I have all in our various ways indicated, it is crucial for the United States and Europe to work together in multilateral institutions.

The alternative kind of institution or arrangement to which some people have referred would be a transatlantic free trade area or other treaty or relationship of some sort. I don't think there is much question but that that idea has appealed to a number of academics, commentators, and others. I also don't think there is much question but that it is premature at this time.

Certainly Europe is in no position to move in that direction. We obviously have not done the kind of analysis and consultations with you and with others that would be necessary, and I think almost as significantly as that, our business leaders did not identify such an arrangement or institution as something which they found a priority that was desirable. They were looking for concrete steps to improve matters. That is exactly what we are looking for as well.

I think that the cooperative links between the United States and Europe are strong. We have tried to strengthen them through this institution of twice-yearly summits between our President and the head of the European Union, and I think that does provide a substantial basis for moving forward.

Chairman GILMAN. Mr. Rothkopf.

Mr. ROTHKOPF. If I may add a couple of comments. I think that the comment that you quoted represents a fairly commonly raised conundrum of the post-cold war era. We had seen a relationship that was the foundation of our policy because of the security component within it, and clearly as the cold war ended the dynamic was going to change. As Bosnia indicates, there is still a need for the security pillar underneath the relationship.

But at the same time, as we have all described, the nature of economic integration between the countries of the EU and the United States is such that we have to focus on the economic pillar as well. We will not be able to achieve our goals within the WTO without cooperation with the EU. We will not be able to achieve the progress we need on key third country issues involving market access or issues like corruption without cooperation with the EU.

So we have an opportunity here to define our relationship not simply in terms of the threat that unified us but also in terms of the mutual interests that can unify us as well, and going forward there is an opportunity as a consequence for a much stronger U.S.-EU relationship than even that which came before.

Chairman GILMAN. The new transatlantic agenda calls for increased cooperation between the European Union and the United States on dealing with drug trafficking, international crime, asylum, and immigration problems. Does the European Union, in fact, have authority to act in those areas on behalf of its member states, or would cooperation between our own Nation and the individual European countries be more appropriate?

Mr. TARULLO. Mr. Chairman, I think the answer is both to that.

We have already in the G–7 process launched an initiative to increase cooperation among the member states at the G–7, which of course includes the four largest European states. We are coupling

that, however, with this initiative in the New Transatlantic Agenda because of a couple of important competencies that the Union does have or is acquiring. First is that of assistance.

The EU has funds available to offer assistance to law enforcement agencies in Central and Eastern Europe and in the states of the former Soviet Union. We, too, obviously, have offered such assistance. Working together with the Commission, we can coordinate our assistance in those areas, make it more effective, and enhance the capacity of all the states of Europe to combat international crime and terrorism.

Second, the European Union is in the process of developing something called Europol. It is not yet a reality, but they are doing so, and there will be a law enforcement function at a European level as well. We thought it was important to ensure that our law enforcement agencies would have links with Europol when it develops, just as we pursue links with the law enforcement agencies of the member states.

Chairman GILMAN. Thank you.

A further question: British Foreign Secretary Rifkind and German Defense Minister Ruehe have suggested that there is a need for greater consultation between Members of Congress and European parliamentarians on issues of common concern. The New Transatlantic Agenda also attaches great importance to enhanced parliamentary links. The European Parliament and U.S. Congress in parliamentary meetings are one example of such consultation.

Do you think there is a need for more contact? We meet twice a year and will be on our way over to meet with them in mid-January once again. I would welcome your thoughts with regard to that.

Mr. TARULLO. Mr. Chairman, the term we used in the declaration was enhancing those contacts. I don't know whether that means that you need to have more contacts, more frequent contacts. I think that is something which is best left up to the Members of the Congress of the United States and to the European Parliament.

What we do think is important is that you have the opportunity to discuss issues of common concern with your counterparts in Brussels. The modalities for doing it and the frequency of it seem to me best left up to you.

Mr. ROTHKOPF. I agree. I think that to the extent to which those interactions reflect some of the issues, for instance, raised in the Transatlantic Business Dialogue, the issues that will be central in the broadening and deepening of the relationship, then those increased contacts will be enhanced and effective. But clearly, as far as the frequency of the contacts or the exact fora in which they take place, the discretion on that should be left to the Congress.

Chairman GILMAN. Gentlemen, I had thought our vice chairman would be able to come back. I have been informed that he is tied up. I am going to declare a brief recess while I go vote, and then we will continue with our hearing.

The committee will stand in recess.

[Recess.]

Mr. BEREUTER [presiding]. The committee will resume its hearing.

Gentlemen, it is my understanding that Mr. Gilman proceeded while I was answering the vote call—which ended up being two votes—and that you completed your testimony. So, in the absence of others members, I would like to begin with some questions. And thank you for your testimony, first of all.

I wanted to ask how this dialogue and the new framework for resolving disputes addresses the differences between, for example, the United States and the European Union over the current and prospective Cuba policy, which applies U.S. laws extraterritorially and therefore affects the European Union and entities.

Mr. TARULLO. Mr. Bereuter, the notion of the New Transatlantic Agenda is not that we have solved all differences between us. I mean, I think that is quite clear. In fact, in many ways the motivating impulse was to find areas where we could make cooperative steps, whether they be political, economic, or in meeting some of these global challenges.

There are issues where we have differences. Cuba is obviously one of them. The meetings in Madrid did not resolve those differences. The New Transatlantic Agenda has not resolved those differences, either.

What we might hope for, however, is that in the spirit which the agenda in Madrid has tried to foster that we may be more successful on a range of issues where we are currently in disagreement with our European allies and come to some understanding about how we are both going to proceed.

Mr. BEREUTER. I have a question that perhaps falls into the same category as the response you just gave. The European Union, I understand, has just issued a sternly written statement concerning the United States' proposal for Iran sanctions legislation which would impose a secondary boycott on European Union oil and gas entities here in the United States.

Does the framework address that problem, or is this one of the disputes remaining?

Mr. TARULLO. With respect to that, Mr. Bereuter, there is reference in the agenda to the need to work cooperatively in dealing with countries that pose threats to international security. Obviously Iran is included in that category. There was no specific addressing of that issue in the Transatlantic Agenda as such, although we did have conversations in Madrid about those differences.

Obviously, we have agreed on the threat posed by Iran. We have not agreed on the measures that ought to be taken in responding to that. It is true as you note that we have received demarches in written and oral form from the European Union. We have noted in response that there doesn't seem to have been success in their policy of a critical dialogue. It hasn't changed the behavior of Iran so far as we have determined and we have been, frankly, disappointed in their unwillingness to date to add economic pressure and leverage to other steps which have been taken.

Mr. BEREUTER. I would ask this question. To what extent are we coordinating our policy toward the admission of China into the World Trade Organization with the EU, Canada, Japan, and the so-called Quad Group?

Mr. TARULLO. Ultimately, of course, that is Ambassador Kantor's province. However, I can tell you that discussion of China and, indeed, other potential entrants into the WTO has been an almost continual subject of discussion between Ambassador Kantor and his Quad counterparts on the one hand but also Deputy USTR Barshefsky and Deputy Assistant USTR Dwoskin. Both of them coordinate, as I say, almost on a daily basis with their counterparts talking about what are the important criteria for any country being admitted.

As you can see in the agenda, there is specific reference to our need to come together on issues of admission because that is quite critical to the future of the WTO.

Mr. BEREUTER. I would like to conclude with a question that relates more directly to Congress' role in a new or improved Transatlantic Dialogue. I am not sure that the subject came up directly, but there has been some interest and, in fact, statements by the German and the U.K. Defense Ministers that we should establish some sort of an interparliamentary exchange on a continuing basis between the nations of the European Union and the U.S. Congress.

We felt that was very interesting and somewhat telling in that we think we have that dialogue through the North Atlantic Assembly and through a 30-year exchange between the House of Representatives at least and the European Parliament. And we were surprised that, in fact, this proposed initiative didn't recognize the fact that the North Atlantic Assembly has already been operating among at least NATO countries, most of the European countries being in the EU already.

I have been told there was some discussion about interparliamentary efforts. Was that a part of this discussion? Has anything been formally decided? Any recommendations that have been forthcoming?

Mr. TARULLO. The way in which the declaration and the agenda dealt with it, sir, is that we affirmed the importance of enhancing parliamentary links across the Atlantic, to be quite forthright in saying we did not purport to address what the modalities of those links ought to be. This is something which in the judgment of the executive branch is best left to the Congress, our Congress, and to their counterparts in Europe. We think it is useful to have you dealing with your counterparts addressing both domestic and international issues of concern, but how you do it is really up to you. It is not for us to try to say.

Mr. BEREUTER. There have been some informal quadrilateral discussions in meetings among the business community, of the European Union businesses, the U.S.' businesses, and the European Parliament in the United States but they have been unofficial.

Mr. Houghton.

Mr. HOUGHTON. Yes. Thank you very much.

I would like to ask two questions. I am sorry to get in here late, we had a vote. The first, I may be dragging you into something you don't want to make any comments on, however I will ask you the question, you can decide what your answer will be.

You have said, Mr. Rothkopf, in your testimony, on page 4, as important as Europe is to us both as a market and as a competitor, perhaps its overwhelming significance is its role as a global partner

for America in opening world markets and in shaping the multinational environment.

You know, we have had a big discussion last night about Bosnia and the fact that it may not be in our national interest, and I guess my position, and I would like maybe both of you to comment if you care to, is that our national interest just can't be confined to those things which we decide are important as far as opening up markets. I mean, there are psychological, there are social, there are political and it seems to me it is a web of interrelationship which affects not just a business but also a relationship. I mean, in the old concept of banking that a relationship is even more important than a transaction. What do you feel about that?

Mr. TARULLO. Well, Mr. Houghton, I think it is an excellent point, particularly in the U.S.-European context.

I had mentioned in my testimony that we were determined not to create a new bureaucracy around the New Transatlantic Agenda.

Now, what is the reason for that? It is twofold.

One, creating new bureaucracy is a counterproductive undertaking in most instances in any case, but, two, the object here is to build on the links which already exist between the United States and Europe. Those links, of course they are State Department to Foreign Ministry. They are Commerce Department to Trade Ministry. They are also Parliament to Parliament, as Mr. Bereuter was just indicating. They are business to business. They ought to be more culture to culture in the sense of educators, scientists, and regulatory agencies as well.

If we can foster those contacts in the widest possible sense, among the people who are doing the work of science or regulation or legislating, then I think we will have achieved what that agenda sets forth for us, which is deepening the political relationship and political cooperation, in promoting our interests abroad through that cooperation, in dealing with new kinds of global challenges, like drugs and international organized crime, and in enhancing our economic well-being through bilateral and multilateral efforts. So I think your premise is absolutely correct, and I hope what we have done in the agenda is to take some steps in that direction.

You know, when we were doing the preparatory work on this, there were proposals for interaction among educational institutions and a variety of nongovernmental elements which there was a tendency for people to categorize it as hands across the water, as that sort of effort.

When you step back you see how important those kinds of links were after World War II, and there is absolutely no reason why we shouldn't try to reorient and reenergize those links today with the new kinds of telecommunications capabilities that we have.

Mr. HOUGHTON. Sure. I guess maybe you are saying the same thing I did, but I just have a feeling that—not that Bosnia or Austria or England is as important as Kansas or New Hampshire, but it is pretty nearly as important.

When we wind these relationships together, so if Europe is going to be critical to us in our future, more critical than almost any other area, other than the North American continent, then we have to take a far broader look than just the economic and the political.

Mr. ROTHKOPF. May I make a comment on that?

Mr. HOUGHTON. Yes.

Mr. ROTHKOPF. I quite agree with you. I think the importance of the relationship and the nature of our national interest is something that we have to define as broadly as possible. And, for instance, our national interest in a situation such as Bosnia is not merely defined by the approximate threat but it is also defined in terms of the longer term consequences of not addressing the problem. And the same is true with a variety of economic issues.

The fact is that if the United States and the European Union, as the source of a disproportionate amount of the world's wealth, choose to work together to address an issue, whether it is a security issue or an economic issue, then we have a much greater chance in the partnership that I alluded to in my testimony of resolving that problem quickly and decisively. And if we allow ourselves to be pushed apart or do not work hard enough to reach an agreement, then we open the opportunity for others to divert the path of events in a way that is not in our interest. And if there are 3 million Americans employed in European companies operating in the United States, or if we have 50 percent more trade and commerce across the Atlantic than the Pacific and something happens that disrupts the economic situation in Europe, it is a Main Street issue in every city and town of the United States.

Mr. HOUGHTON. Absolutely.

Well, thank you very much.

Do I have just a minute? Because I would like to ask another question, very briefly.

You talk about the Seville conference, and maybe I am going back in my own memory dump a little too much, but I have gone to conference after conference after conference and I don't know what happens at them but I am putting a fine point in order to get an answer on this thing. Standards and regulatory issues, we talked about that for a decade. A trade liberalization, the same thing. Investment. What comes out of these things? What specifically are we going to do differently tomorrow because of the conference than we did yesterday?

Mr. ROTHKOPF. Well, I will try—first of all, nothing comes out of the governments, you know. Read the transcripts or ignore the transcripts——

Mr. HOUGHTON. There were 70 recommendations clustered into four areas and it is very, very impressive and I am sure it is, but I don't quite see what comes out at the end.

Mr. ROTHKOPF. This is what I want to address. First of all, going in, the governments had different views about this conference. Leon Britton at the conference said that he was skeptical of the process.

Having sat through the process, having seen consensus on issues where consensus was surprising, whether it is on standards broadly, standards pertaining to the automotive industry specifically, or on an issue such as corruption and bribery, when he saw that the business leaders of both sides of the Atlantic had come to a consensus in a fairly short period of time on this, he said we have to take this seriously and we have to respond to it. There was a commitment on the part of Sir Leon as well as on the part of Secretary

Brown and the others who participated in the meeting to ensure that the government followed through on this, and there is a steering committee that has been created to——

Mr. HOUGHTON. Can I just interrupt a minute?

Mr. ROTHKOPF. Sure.

Mr. HOUGHTON. Standards, we talked about that for years and it is the most difficult thing for an American company to get its products or its services, particularly its products, introduced and accepted into any European purchasing scheme because they will not give us or accept the standards that we have or they will not give us any indication what the parameters are for purchasing decisions. It is very, very difficult. It comes up now, it is a great idea. I would assume that maybe 2 years from now we will be talking about the same thing.

Mr. TARULLO. Mr. Houghton, if I could just interject as one who was on the receiving end of a lot of the recommendations of the Transatlantic Business Dialogue, I found its utility to be quite unusual in the following respects. First, well before Seville, representatives of the U.S. chairs contacted us. We contacted them and we tried to sit down and see where our respective agendas were going. There was more interchange, although no one purported to be speaking for anybody else or to the government for business or the business for the government. We were able to see where there were potential points of convergence. That is the first point.

Second point is there were some things where we and our business people had agreed quite independently that action was vital, was important, such as some of the Uruguay Round's zero-for-zero tariff reductions.

Our business people were extraordinarily useful in pushing these ideas to their European counterparts and making progress with their own governments so that that ended up in the declaration.

Now, on standards you are absolutely correct. Standards is with us and it will be with us for a long time. Standards are not like tariffs, you don't just remove or reduce a tariff and then it has gone as a barrier. It is bound up often with issues of health, safety and interoperability of different products. So it is going to be a lot of work on a sector-by-sector basis.

But what did this exercise do?

First, the business people identified areas where they thought we should begin and make progress. I think that they are right in the areas that they identified. Second, they brought it on to their agendas, we brought it on to the agenda of our heads, in our case our head of government, and in the case of the European Union, their president, to indicate that this was something of sufficient import, if not complexity, that they ought to lend their names and political impetus to moving it along. And even as we speak, my colleague Jeff Lange is in Europe trying to move the discussions on a couple of these sectoral mutual recognition agreements along by addressing it with his counterparts.

So, yes, you are right, 2 years from now we are still going to be doing standards. But if we have done our job, we will have four or five agreements done and we will have moved on to four or five others.

Mr. HOUGHTON. OK, good. Thank you. I am sorry to take so much time, Mr. Chairman.

Mr. BEREUTER. Not at all. Good question. We appreciate your responses, and those standards oftentimes have been used, in our judgment, as nontariff barriers.

Chairman Gilman.

Chairman GILMAN. Thank you, Mr. Chairman.

Let me address the panel on this question. To what extent has the United States, the European Union, and/or its member states fully implemented the 1994 OECD recommendations on bribery in international transactions?

I know our Commerce Department has issued an in-depth study of this problem and I would welcome—how do we go about encouraging member states to adopt legislation of this nature, including tax legislation, regulation, practices? I understand a number of the countries give tax breaks to those who engage in bribery. A tax break on bribery?

Mr. TARULLO. The latter observation is a correct one, Mr. Chairman, and one which has certainly confounded me for the two and a half years I have been working on this issue. We negotiated in the OECD in late 1993 a recommendation that the member states of the OECD should take concrete and significant steps to deal with the problem of illicit payment abroad.

Chairman GILMAN. Are they doing that?

Mr. TARULLO. Some of the member states have done so.

We then launched a follow-up effort on some of the specific items, the first one being tax deductibility, which you alluded to. We anticipate that in late January there will be a joint report by the Committee on Fiscal Affairs in the OECD and the Committee on Bribery in the OECD that member states should not provide tax deductions for bribes that are made by their companies abroad. We anticipate that that report will be adopted by the OECD ministers in their ministerial meeting in the spring and then we, the United States, will expect, anticipate, and urge that necessary changes in tax legislation be made.

To follow up——

Chairman GILMAN. Are we providing any teeth in those proposals from our standpoint?

Mr. TARULLO. Well, we are not providing—we have yet to get the international agreement, the international recommendation that these steps be taken, and it seems to me that is the first thing we need to do. Then we need to see what happens with implementation. If we have a problem with implementation, we will need to return to that issue. Right now I think with the public attention dedicated to the problems of bribery and with the case that we have made, it is my hope that countries will react favorably to the recommendation.

Mr. ROTHKOPF. If I may make a couple of points, I think the efforts within the OECD are certainly encouraging. We, as a consequence of the Commerce study that you made reference to earlier, are also exploring a broad range of other avenues. We cannot limit our efforts to any one forum.

The State Department is also undertaking an effort within the context of the OAS. The issue has been raised within the context

of APEC. We are going to push the issue more aggressively within the context of multilateral financial institutions, such as the World Bank, that have terms on the books concerning bribery and corruption, but which often don't enforce them as aggressively as they can.

We have to address the issue both on the supply side and on the demand side, and in the future we see a burgeoning of opportunity as far as fighting corruption is concerned in terms of the 150 or so largest projects in the world that are worth about $1 trillion and have the distinction of being the big commercial game on the planet right now.

In most of them, governments are making the decisions. Opportunities for these kinds of practices are ripe. And the motivation to engage in these practices will be overwhelming whether or not they are tax deductible.

So we are going to have to step up our efforts against bribery, although I must say that in the past several months there has been a changing sense in the global community that now is the time, because companies see this as an unfair burden on them and countries see it as a tax on the world's poorest people which, in fact, it is.

Chairman GILMAN. Thank you very much. Thank you, Mr. Chairman.

Mr. BEREUTER. Thank you, Mr. Chairman.

Mr. Roth, do you have questions?

Mr. ROTH. Well, I just have a short question.

Mr. BEREUTER. Mr. Roth is recognized.

Mr. ROTH. Thank you, Mr. Chairman.

I have been looking at this for a good number of years, and I appreciate the great briefing you gave me before I went to South Korea, too.

Mr. TARULLO. Thank you.

Mr. ROTH. I appreciate that. It was very helpful when I was talking with the Koreans on the economy and on trade.

I always sense that there isn't really a political will in Europe to take bribery out of their trade arsenal because it gives them such tremendous advantage. What do you think?

Mr. TARULLO. I have had that feeling from time to time, too, Mr. Roth. I think that there has been a change over the last couple of years. You have had domestic bribery scandals in a number of countries and the efforts by some to say, well, we need to stamp out domestic bribery but we can tolerate it abroad seemed to me to just fly in the face of reality. You can't segment bribery. If you allow your companies to do it in one part of the world, they will inevitably do it elsewhere.

I found when I was visiting the OECD to discuss this that there was enormous press interest in the European press. They wanted to hear about these efforts and they wrote an awful lot of stories about them.

I believe that public sentiment in Europe is actually working in our favor here, as are the forces that David referred to, including some of the countries in which the bribery takes place because some of those countries are now beginning to stand up and say, we

want you to police your own companies because we know that we can't always police our own bureaucracies.

Mr. ROTHKOPF. I might add, I agree with what Dan has just said and reinforce it. I think while there has been a bit of a change in the past several months, and that is certainly encouraging, I think we have a long way to go and I think a large reason for the change has been our willingness as a government, whether it be by Members of Congress or by members of the Administration or by members of the business community, to call people on this issue when we see it happening. And there is no diminution in this activity around the world right now, quite the contrary, as a result of the explosion in infrastructure projects in the developing world. We are going to have to intensify our efforts if we want to take advantage of the change that Dan and I both referred to.

Mr. ROTH. Thank you very much. Thank you, Mr. Chairman.

Mr. BEREUTER. Thank you, Mr. Roth.

Gentlemen, thank you very much for your testimony and your responses to our questions. There are members who might have questions. I would appreciate it if you could provide response to those. So on behalf of Chairman Gilman and members, thank you for your cooperation and assistance.

Mr. TARULLO. Thank you.

Mr. BEREUTER. I turn over the Chair to Chairman Gilman. I would like to call panel No. 2 to the desk.

Chairman GILMAN [presiding]. I ask our witnesses for the second panel to please come up to the witness table.

I would like to welcome our panelists, former Congressman William Frenzel, former Member for 20 years, formerly Ranking Minority Member of the House Budget Committee. Also a member of the House Ways and Means Committee and our expert on trade. He was also a member of the Subcommittee on Trade. In 1993, Mr. Frenzel was appointed Special Advisor to the President for NAFTA and in 1994 he was appointed Special Advisor to the National Association of Manufacturers for the GATT-Uruguay Round. Presently he is a guest scholar at the Brookings Institute and Chairman of the Transatlantic Policy Network, a group of United States and European businesses. European parliamentarians and Members of Congress have come to know Mr. Frenzel as our expert on trade relations between our two continents. We welcome Mr. Frenzel. It is a pleasure to have you back with us once again.

Mr. FRENZEL. Thank you very much, Mr. Chairman.

Chairman GILMAN. And Mr. Michael Farren. Mr. Farren is currently Vice President of External Affairs with the Xerox Corporation, holds the position of Corporate Vice President at Xerox, responsible for managing Xerox and Xerox financial service activities involving trade associations and other public and private interest organizations. Mr. Farren has previously served as Under Secretary for International Trade at the U.S. Commerce Department from 1989 to 1992 as well as Director of the Office of Business Liaison in 1983. Welcome, Mr. Farren.

Gentlemen, you may put your full statement in the record and summarize or as you see fit. Why don't we start off with Mr. Frenzel.

STATEMENT OF HON. WILLIAM FRENZEL, U.S. TRANSATLANTIC POLICY NETWORK

Mr. FRENZEL. Thank you very much, Mr. Chairman. I greatly appreciate having this chance to speak with the committee on what I think is a very important subject.

I would state for the record first that the views that I present are my own. They are not those of the Brookings Institution, nor of the Transatlantic Policy Network which you mentioned earlier in your introduction.

This is a very complicated subject and one hardly knows how to approach it. I have given the committee sort of an outline that I think will be helpful in understanding what is happening out there. The group to which I belong, the Transatlantic Policy Network, has published what began to be a European strategy for transatlantic relationships and later was expanded with the approval of its U.S. membership, as well, into kind of a long-term idea of how the U.S. and the EU might integrate their economies to make business and other links between the United States and the EU function much more easily or perform better.

Following that, there arose a great deal of interest on the part of public figures and business people, particularly the new Spanish presidency in the EU which has taken this Transatlantic Business Dialogue and the Madrid summit to be the primary goal of its presidency. And so this business dialogue began.

My friend, Mike Farren, is here. He was in Seville. He was a principal Sherpa for all of the four U.S. working groups and he can fill you in far better than I can on what happened there.

But I think the interesting part is that this is a meeting of business people, CEO's from both sides of the Atlantic. The Americans largely had large operations in Europe. The Europeans largely had huge operations in the United States. These are international businesses looking for ways to make life easier for themselves as they try to increase economic activity on both sides of the Atlantic.

The other thing that is interesting about it is that it was terribly well organized. There was a huge network of staffing assistants that ran through various corporations, various associations in the United States and abroad.

Another interesting part was that those networks of staffs cooperated across the Atlantic so that before they sat down, people on both sides of the Atlantic had a pretty good idea of what they wanted and what they didn't want and where the points of friction were. To the amazement of everybody, including myself, at the end of the day, they published a list of conclusions which I think are important ones and ought to be of great interest to this committee.

Following up on that, at the regular Atlantic summit, President Santer and President Clinton met and endorsed almost everything that was in the business dialogue conclusions. I believe that there are six elements of the business dialogue that did not find their way into the action plan, and as far as I am concerned I think only two of them are important, that of product liability and of transportation, both of which came out of Group 2 in the business dialogue. But nevertheless, they followed very closely. And so that is the history.

The question I think for this committee to decide is what does Congress want to do with what now is out there. In the first place I think the world believes the Congress has allowed its international policies to languish. We know that the Congress has been working very hard on the budget, and other domestic interests. They have consumed most of its energies. I think there is some feeling out there that the United States has not been properly interested in nor friendly to our trading partners and allies in Europe, and I have noted that in my outline.

But what I think is important to note from all of these publications which I have referenced is that there are new opportunities for us to the east. In addition to investment agreements and bribery agreements and regulatory cooperation, competition policies, testing, certification, customs, communications, there are many other opportunities to improve business, to build trade activity and to build jobs on both sides of the Atlantic. We have been presented with this opportunity largely through the efforts of the business community.

Now, there are other opportunities as well. Chairman Gilman had some questions about others of them. They would be drugs and terrorism, refugees, health, the environment, and others. And, of course, there is the security dimension of our relationship. That is not my strong suit and I don't particularly want to get into that because you all know more about that than I do. But there is a wide range of opportunities through which the United States and Europe can draw themselves more closely together to their mutual benefit.

Part of the title of my presentation was, Is there a NAFTA in our future? The answer to that is yes, but don't ask me when and don't hold your breath till it comes along. A long time, anyway. But what can happen in the meantime is to proceed with the agreements outlined, and Mr. Farren will fill in a number that are very important to his business associates who were at that Seville meeting.

There is much that can be done without benefit of enactment of law but it isn't going to be done well or rightly unless the Congress participates, helps and ultimately encourages. And I think you will see from the action plan exactly where you find a need to fit into the situation.

I think you will be counseling with your business advisors, as you are today through Mr. Farren and others. One of the differences about this set of meetings is that businesses are not often very well-coordinated or organized. This time they were uncharacteristically well-organized and well-coordinated. They want to get your attention and they may be around to see you on the subject.

So we are not going to get a NAFTA very suddenly. How long did it take us to do Uruguay? 1979 to 1994, 15 years. Most of the time stonewalled by the very people that I am telling you are going to provide you with this whole new range of opportunities. In fact, often the European Union has seemed to make our Japanese friends look soft and compliant. But now they are signaling, I think very obviously, that there is ground to be gained on both sides of the Atlantic. This is an opportunity, Mr. Chairman, I hope your

committee will take advantage of, and as a matter of fact I know that it will.

On some of the other matters in which I am less qualified to speak, the committee is already at work and following on a regular basis. Those are some of those nontrade advantages. I see opportunities out there, Mr. Chairman. A lot of Americans look just to the hemisphere or to APEC for improvement in our economic situation. I think we have got extraordinary opportunities to the east and that is where our most long-standing and strongest relationships have been and I hope the committee will take advantage of it.

Thank you, Mr. Chairman.

[An outline of Mr. Frenzel's testimony appears in the appendix.]

Chairman GILMAN. Thank you, Mr. Frenzel, for your excellent testimony.

Chairman GILMAN. I am going to turn the Chair over momentarily to our Vice Chairman, Mr. Bereuter.

Mr. BEREUTER [presiding]. Mr. Farren, we look forward to your testimony. You may proceed as you wish. Your entire statement will be made a part of the record.

STATEMENT OF J. MICHAEL FARREN, VICE PRESIDENT FOR EXTERNAL AFFAIRS WITH XEROX CORPORATION, TRANSATLANTIC BUSINESS DIALOGUE

Mr. FARREN. Thank you, Mr. Chairman. I am pleased to be here today to talk about the business dialogue and the implications of the process that was initiated in Seville. Let me first indicate my role in the dialogue was to serve as support to Mr. Paul Allaire, the CEO of Xerox who served as cochair of the U.S. business delegation. He shared that responsibility with Alex Trotman of Ford Motor Company.

The report issued at the conclusion of the dialogue spells out in detail the recommendations that were the result of agreement among the 100 business leaders and attendants. I won't go through those 70 recommendations but have copies of that conclusion that could perhaps be made part of the record.

I would like to take the time today to comment on the implications of the dialogue on the business community and on the transatlantic marketplace. The prime accomplishment in the dialogue was the astonishing success of the business community in arriving at common conclusions and creating a comprehensive document. The document offers specific and meaningful recommendations that truly constitute a business-led agenda for the creation of a new transatlantic marketplace.

A valuable by-product of the dialogue was the ability, in fact, the necessity of the U.S. and European participants to organize themselves and establish priorities that reflect the common interests of the transatlantic business community. We wanted the recommendations to reflect the priorities of a single transatlantic business community rather than the fractured views of two disparate communities separated by conflicts more divisive than even the Atlantic itself. We sought to avoid an atmosphere of bitter negotiations and rather create a sense of partnership. The participants succeeded in addressing issues and recommendations as a single

business community linked by a common interest in removing the remaining government impediments to trade.

The experience of both the U.S. and European participants offers a model for future efforts to forge a business agenda of common interest. The follow-up process will be a lesson in advocacy as business presses for government implementation. It will also be a difficult ongoing task to keep the recommendations current and relevant.

The Seville recommendations constitute an amalgam of sectorial issues and goals. Seville demonstrated that sectorial issues can be combined into a broader transatlantic business agenda and provide a synergy that accelerates overall implementation. The follow-up is reliant on individual sectors energetically pursuing their specific objectives and serving as a catalyst to eliminate broader market-wide restrictions.

The business community must maintain the cohesive interest reflected in the Seville conclusions and the governments need to take prompt and tangible steps to implement the recommendations. Seville illustrated the role that the marketplace and business can serve in supporting the overall political and economic transatlantic relationship. The approach taken by business leaders in formulating recommendations demonstrated their commitment to the World Trade Organization and the multilateral trading system. The benefits of a stronger U.S.-EU marketplace will ultimately be shared by the nearly 130 WTO member nations.

The Madrid summit on December 3 was an appropriate first step to implement the Seville recommendations and to keep the momentum of the Transatlantic Business Dialogue. The Presidents called the dialogue an "integral part" of the action plan that was adopted in Madrid. They called for appropriate government officials to work closely with business on the implementation of the recommendations. Specific aspects of the recommendations were also cited by the Presidents. Most importantly, the Presidents called on government officials to report at the next U.S.-EU summit on the progress made in implementing the Seville recommendations.

It was a clear signal that business can spur governments to act provided our positions are concise, specific, and reflect the consensus of the transatlantic business community. Taken together, the Seville recommendations, the process of business community cooperation that took form in Seville and the Madrid summit's action plan provide a unique opportunity to significantly accelerate the integration of the transatlantic marketplace.

Alex Trotman of Ford and Jurgen Strube of BASF have volunteered to cochair the follow-up process in 1996. They will find the best means to press for implementation of the recommendations, continue the dialogues on issues needing further consideration and arrange a follow-up meeting in the United States sometime in 1996. We have been most encouraged also by the enthusiasm of those who attended Seville to keep the process moving.

That process needs the active support of national governments. Our European business counterparts have the even more difficult task of taking the message beyond Brussels and the commission to the individual 15 national governments. On the U.S. side, we will

need the help of Congress, the Administration, and just as importantly the support of individual regulatory agencies.

We are grateful for the role that our government officials have already played. Secretary Brown initiated the dialogue through his initial proposal to the EU commission and the Commerce Department led an interagency effort to convene the conference. High level officials from Commerce, USTR, State, the FCC, FDA, and other regulatory agencies attended the dialogue. The government participants in Seville did what does not always come naturally to many in government: They listened. Following Seville, the Administration made every effort to have the Dialogue's recommendations incorporated into the Madrid summit's action plan.

To close, I can best summarize the view of business by referencing the actual statement adopted by the participants of the Dialogue at the conclusion of the conference, "The U.S. and European business leaders meeting in Seville are determined to take this process further. Action is needed to liberalize trade and investment, to remove public policy impediments to the operation of the market and to encourage cooperation on wider international issues. Such action will do more than almost anything else to build prosperity and create jobs."

Thank you.

Mr. BEREUTER. Thank you very much, Mr. Farren. Thanks to both of you for your excellent testimony.

[The prepared statement of Mr. Farren appears in the appendix.]

Mr. BEREUTER. Congressman Frenzel, I notice, good friend, that you are still working on your abstractions there, and you can label this one abstraction international relations, but you never miss anything that goes on while you are doing it.

I think that what you gentlemen are doing in your respective positions is very important to the transatlantic dialogue. As my friend Bill Frenzel knows, occasionally I get frustrated with the language of communication between the European Community and the United States in particular, so perhaps among other things you can try to de-Brusselize the language so that we can really understand what they are talking about, what their concerns are, and how to proceed. Undoubtedly, we have our own language that boggles them, too. But I think that you are not only good in giving us the business perspective on both sides of the Atlantic, but I hope that you can bring more specificity to your concerns, more importantly to the European Union's governmental concerns, than sometimes has been the case.

I don't know how far off TAFTA is, but at the San Francisco meeting with the European Parliament, 2004 was pulled out of the air. I do think we will make the movement and it will be gradual. There will be exceptions, but we have to have the kinds of dialogue and preparation in which you are both so valuably involved at this point.

I am going to turn to Mr. Payne for any questions that he might have.

Mr. PAYNE. Thank you very much, Mr. Chairman.

Let me just welcome our former colleague, Mr. Frenzel, back and let me just say that the whole question of the European Community and trade between United States and Europe I think is really

interesting and I just wonder if you could tell us how do you think the European customs group, how far will that grow? Will that eventually include, do you think, Turkey and Greece and Cyprus and just what impact will that have on a developed western Europe and a European Union and some less developed parts of eastern and central Europe?

Mr. FRENZEL. Mr. Chairman, Congressman Payne, thank you for your welcome. I don't have a very good crystal ball on this subject. As you know, the Europeans throw around a lot of phrases like customs union and economic space and one wonders except that the history of the development of EU has been one of steady expansion.

Mr. FRENZEL. At some point, it will get a little too big and too cumbersome to expand, and the voting blocks will get set in such a way that they can't stand to be disturbed. If I were to guess, I would say that there are three central European states who have been given assurances, not promises, that they will be let in, and that would be Poland, Hungary and the Czech Republic, maybe the Slovakians as well.

I would guess further that to let others in would put terrible burdens on the union that it probably could not tolerate fiscally. Just as Germany had trouble swallowing East Germany, I don't think anybody is about to step up to swallowing Romania and Bulgaria, et cetera.

I think there are obvious political problems about Turkey. That is one of the items that was in the Madrid Summit. The Europeans have responded very well and quickly, I think, with a very strong vote in the European Parliament last night accepting Turkey into the Customs Union, which gives Turkey a lot of advantages which it never had. That vote is going to not flood Europe, but it is going to result in a huge expansion of Turkish textile trade into Europe. It is going to displace some of the current suppliers.

I think the Europeans have done a good job on that one. It was pretty tough to take Turkey in, but they have done everything but that. That is my guess on how things will go.

Mr. FARREN. I would agree with Bill's assessment. I think the Europeans in the last few years recognize the fact that they will have to adjust their pace as they go into the lesser-developed countries, and it has led to this concept that you will have a core area where there is much greater integration than in the lesser developed areas, and it will have to be over a longer time path that they get integrated into what we now view as the European Union. Tariffs, standards, much of what we addressed in Seville as it related to U.S.-EU interests would also be an issue for the EU to be addressing with countries in Central Europe and beyond.

Mr. PAYNE. Do you think that might have political ramifications such as the situation in Cyprus where there is a move afoot to really try to bring that 20-year problem—it was thought if Turkey was invited in that maybe there could be some solution to a divided Cyprus.

Mr. FRENZEL. It is devoutly to be hoped, but I have no special knowledge of Cyprus or political developments there.

Mr. PAYNE. Do you think there will in the near future be an Euro dollar or pound?

Mr. FRENZEL. My answer is yes, but I can't define near future for you. I think nobody likes the term ECU, so we will be talking about Euros or some other more harmless sounding name. I think ultimately they have to get to some common form of currency, but it is hard going. The sovereign governments and sovereign people have a hard time swallowing that one.

I think it can be done, but if we are talking about the Intergovernmental Conferences of next year, no, I don't think they are going to be able to make that. So maybe what, 5 or 6 years, guessing.

Mr. FARREN. I agree with Bill; I think it is ultimately inevitable. The current time path to get there plausibly somewhere before the end of this century, somewhere before 1999, is going to require some very difficult political decisions. And to a degree, we have seen in the streets of Paris the reaction to some of those difficult budget and economic decisions that individual governments will have to make. So that leaves open the question of what is now a very aggressive and optimistic time path, whether they will be able to actually achieve it.

Mr. PAYNE. Thank you very much.

I guess the last argument would be whose picture goes on it? That would be interesting.

Mr. FRENZEL. It will either be Schuman or Monet.

Mr. ROTH [presiding]. Thank you.

Mr. Farren, did the business leaders discuss anything about unilateral sanctions. For instance, we are having a big debate behind the scenes on Iran, what we are going to do; did that come up?

Mr. FARREN. Yes. In Group 4, the third country group, there was reference to the need for any issue such as sanctions to be addressed on a multilateral basis rather than a unilateral basis.

Mr. ROTH. What did they have to say about what the United States is doing with Iran?

Mr. FARREN. Nothing as it relates specifically to Iran. It was discussed in broad concept, at least in the document that was issued from Group 4.

Mr. ROTH. Did Cuba come up?

Mr. FARREN. It may have come up in discussion. I was not in Group 4. But in the actual document, no particular sanctions railroad referenced per se.

Mr. ROTH. Mr. Frenzel, every year I have this exports conference, and we had some 1,100 people there this year. I say that not to impress you but to impress upon you that it seems that the business community and government are growing further and further apart all the time. Our businesspeople are concerned about the government just not paying attention to them or that things are moving so fast that government is just an impediment. Don't you think it would be wise if we had the CEO's, maybe a group like yourselves, bring the business and government people together to have a real seminar on this, to have a good give and take? Because we are growing further and further apart all the time. I think it is rapidity of change that is doing it.

Mr. FRENZEL. I think that is a splendid idea.

Mr. Farren might be able to find you a group of CEO's who would really like to get together with you specifically on Europe

but generally on the global thing that you are talking about. There is one other forum that is working pretty well. Your colleague, Mr. Houghton, meets a group for dinner every now and then at which time he occasionally produces CEO's, and that would be a splendid topic for some of his discussions.

But I think if ever a group of Congressmen wants to meet and can set up a time certain, there would be no difficulty in getting a group together and I would suggest a relatively small group, perhaps those who have been through the dialogue experience so that you could have a good moving discussion.

Mr. ROTH. I must say Amo is sitting way down here. I didn't see him. I am going to be calling on him. I would have called on him before. We will get to you very shortly.

I have been thinking about this over the years.

The Congress is an 18th century institution and the committee system really isn't working the way it should work. Things are taking too long and I think that CEO's could have a tremendous impact on what is happening in government if we had an inside-outside punch is what I call it, because I don't think that the people in Congress understand the business community well enough and the business community doesn't understand always how Congress works.

I think we have to have a dialogue, maybe business educating Congress and Congress educating business. This is important, because every bill that comes up we are not singing out of the same hymn book.

Mr. FRENZEL. I concur, Mr. Chairman. Each has a vision of reality which is half full.

Mr. ROTH. Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman.

I have really just got one question, and that is in terms of getting something done. And I guess it relates to an issue that I referred to earlier in terms of some of the general concept and meeting together. Here is this document I have, Transatlantic Business Dialogue, I guess it is a report of the Seville meeting. This is on telecommunications. EU and U.S. firms should have restrictions.

Mr. HOUGHTON. Now, telecommunications is a hot issue here. It probably is the greatest job producer that we have had since the CCC. No government money, all private money.

This is an important relationship, specifically right now, right today between the United States and Europe, and so what will come out of this other than a sort of platitudinous statement that this is a good thing to join hands and be happy and look forward to technology and reaching appropriate agreements.

Is this the vehicle?

Let me say one other thing; I have always felt that if the relationship between Europe and the United States is as important and should be as strong as we say it is, then we should really have something like a business roundtable which should be an European-American roundtable, not a business council, which is sort of an advisory group listening and talking, but something to take it the next step to get something done.

Maybe I confuse the issue by getting to the roundtable issue, but technology and business and the thrust of science is moving so fast

that I hope we are just not doing the same type of things and letting this thing founder.

Mr. FRENZEL. I would answer, and Mike will give you the right answer, because he is going to tell you about the follow-up mechanism, which is really the only way that is going to make it work. But there is a range of outcomes from nothing, just the pious platitudes of the Madrid summit to some really concrete agreements and changes in orders and the way we do business across the ocean, particularly with respect to testing and certification which you mentioned earlier, and telecommunications.

Both of those seem to be a prime prospect and neither, at least in the forms that I conceive, needs the force of a law for enactment. It can simply be an agreement between the EU and the United States. And those are the most important things.

If we can begin to make a few of those steps then this movement will develop some momentum and be able to carry forward to most of the outcomes, I hope, that are in the conclusions of the business dialogue.

There are three major playing groups: There is the bureaucracy; that is the European commission and the people you heard from before this panel came on our side, State, Commerce, the Security Council, USTR, whoever is in that club.

The second group are the parliamentarians in Europe and the parliamentarians in the United States.

The third are the business communities on both sides. The business community, it seems to me has made the commitment to try to keep the pressure on. Mike can explain that. So far the Congress has been the least interested of these groups.

The Administrations on both sides, the European Parliament is following this more closely than our Congress is, unless you are doing some things that I don't understand. But the key to success is going to be whether the business community keeps the heat on, and Mike can tell you about that.

Mr. FARREN. Congressman, I think one of the most important things to come out of the Madrid December 3rd agreement or agenda was the fact that both presidents said they wanted a report at the next summit on what had occurred on the recommendations. That will be this summer.

Having spent about 10 years in the Commerce Department, I know that there is nothing that moves an agenda like an upcoming meeting of heads of government.

Mr. HOUGHTON. Maybe they should have it in January.

Mr. FARREN. I think there is a mechanism.

The other unique thing about what came out of Seville is these are very specific with timetables. When the U.S. and European sherpas, those who staffed out the preparation, started talking about what form the document should take, we used the first lesson in any journalism class, that the recommendation should have who, what, where, when why built into it. The when is very important. So on every recommendation was discussed what is the timetable. That is the type of measure that government officials will presumably have to report to the respective presidents come summer.

Your other point on the roundtable I think is a good one. I know going back to your business days, you probably recall that in the mid-1980's, there was an effort leading up to EC–92 to get a better dialogue going and the U.S. business roundtable attempted to spur that on. It never particularly worked well, in large measure because the EU business community is not organized. You are still looking at a number of multinational companies but, by and large, they are organized on a national basis so you have 15 individual clubs every now and then trying to come together and reach some consensus.

Uniquely in Seville, they were spurred to in fact come to an agreement and state a position and get specific. I think personally that may be one of the most important things to come out of the dialogue, and that is the willingness, in fact the necessity of the European businesspeople to come together and have their act together the next time they come and talk to us. The comments post-Seville, interestingly enough, the criticism offered from the European side to the extent there were some, were not directed at individual recommendations but more to the process, that the United States was better coordinated, that the United States was better organized, that the United States came in with a set of goals and that the Europeans had to hold back this onslaught of U.S. preparation somehow, clearly overstating what occurred, because the Europeans did come in prepared, but illustrating that they are not accustomed to organizing on an EU-wide base. In 1990 at the GATT ministerial meeting, as we were trying to conclude GATT in 1990, one of the European negotiators commented to me that he wished the EU had an industry sector advisory committee process, the United States does, that basically they were in large measure flying blind as to what the continental-wide view of the European business communities was. I think some of those same commission officials are encouraged by virtue of Seville that they may have a more consolidated voice coming out of European business.

You referenced telecommunications. One of the reasons we didn't reach an agreement on telecommunication in the GATT was the EU was not far enough along in its own telecommunications reform. Individual countries were. And the United States wanted to take a reservation awaiting that liberalization, and ultimately the concept of the United States in any way reserving on telecom caused the whole process to come to a stop.

The Europeans have set a goal of January 1998, to integrate their telecom market. We need to have a meaningful dialogue with them as they do that. It ought to be business to business, and it ought to talk about the telecom market not as a government regulator would. Only then can we look at the EU telecom agreement really taking a form that we will be comfortable with from the U.S. side.

Mr. HOUGHTON. I understand what you say and that is probably the best way to do it. However, I think we sort of operate from crisis to crisis and whether we realize it or not, there is a crisis in Europe, particularly in France. The economic crisis in France could topple that government. There is 12 percent unemployment. This is the type of thing, and I just happened to pick telecommunication—pick any one of several things, where we really could get

together and do something extraordinary as we do in a military or in a political sense, but I didn't see the drive to do that. It set the stage, created the environment but nothing specific. That is what I sort of missed from this whole thing.

Mr. FRENZEL. I think that there is some of it there. It is not as well organized in Europe. European businesspeople have not been as straightforward or as well organized in approaching their government. They have tended to use back channels and personal relationships and have tended to accept more regulation and more opacity, than Americans have wanted to accept. They are now being pushed, in the same way American companies are, into this global market and they have to have the certainties, and I think more and more we will see them working with our companies. They, after all, started this whole thing.

There are a number of transatlantic organizations from the Chamber of Commerce to the group I work with. The acting chairman and I have been active in another, IMDI. There are many of these groups, and I think if conditions call for such a group or a new group or an umbrella group to be put together, then that is likely to happen in the next 4 or 5 years, just because there are going to be so many benefits from it. CEO's notoriously follow the buck and the buck is international and the——

Mr. HOUGHTON. You mean the ECU?

Mr. FRENZEL. Euro.

Mr. ROTH. Thank you, Mr. Houghton, for your penetrating questions.

We are going to ask the Chairman, Mr. Gilman, for his questions.

Chairman GILMAN. Thank you.

I regret I had to step out. To what extent are we coordinating our policy toward the admission of China into the World Trade Organization with the EU, with Canada, with Japan and the Quad Group, and what other issues are we developing jointly or cooperatively? That is to both panelists.

Mr. FRENZEL. Mike says he doesn't want that ball.

Mr. Chairman, I think that we are coordinated rather well with the European Union on China. Clearly it is the U.S.'s position, and, so far, the European Union hasn't bailed out on us. How long that will last, I suspect depends on the strength of the relationship and how other things pull together. I will just say as near as I can see, so far so good.

Chairman GILMAN. Does the EU have its own position in the OECD-sponsored investment discussions?

Mr. FARREN. Mr. Chairman, maybe I can comment on China, because that was discussed rather extensively. In fact, it was one of the more controversial points in Group 4, the third country working group in Seville. It was discussed and it was controversial.

We ultimately did arrive at language that both the European and the U.S. businesspeople agreed to. And it basically said that all new countries seeking admission to the WTO should accede on commercially viable terms, and at the same time technical assistance should be offered to them on how to go about doing that.

I think it is language that didn't do damage to either the European or the U.S. position, but it probably reflects the difficulty in

reaching an accommodation with the Europeans on how to handle the China accession. As someone in the Administration stated it to me not long ago, the Europeans are very happy when it comes to China to hold our coat as we step into the ring. That in large measure——

Chairman GILMAN. That seems to be rather fashionable.

Mr. FARREN. Yes. On issues beyond the WTO.

Fortunately, they have been willing to back us up, stand behind us as our negotiators go in, and they could just as easily cut and run and try to do their own deal in terms of the accession.

I think Bill is correct, so far there has been that degree of solidarity but certainly, given the implications of China joining the WTO, it would make a lot of sense for much closer coordination than has occurred to date.

Chairman GILMAN. In 1995, the foreign trade barriers report of the USTR devotes some 28 pages to a discussion of the ongoing trade and investment disputes between our Nation and the EU. What are the main issues of concern and how can they be resolved at the same time we are trying to inject new momentum to further global trade liberalization?

Mr. FRENZEL. Mr. Chairman, from my standpoint, I have stopped reading the report of the USTR on bad things happening around the world, and at the same time I stopped reading the EU's report back at all the bad things we were doing to them. Instead, I have tried to concentrate on things in the transatlantic dialogue where we think we can do better. Many of them bear on the subjects that are part of those so-called barrier reports and would result in taking them down on both sides of the Atlantic. But I really couldn't go through them in chapter and verse.

Mr. FARREN. I was Deputy Under Secretary for Trade and Commerce during the Reagan administration and was involved in writing the first barrier report. I can say maybe one reason Bill doesn't have to read it, it hasn't changed an awful lot since that first report was done. But I think we did take the approach in Seville that there are some impediments that are at the moment intractable.

You can take a positive approach in the context of a business dialogue and get something done. We tried to make a point of avoiding some of those and went after what we would describe as the low-hanging fruit, the things that clearly there ought to be some easy common consensus.

We found more in Seville than anyone had hoped between the business communities, and now we need to find that consensus among the governments.

Chairman GILMAN. What can we do to find that consensus?

Mr. FARREN. I think the reference that you made to your visit to Europe in January is a very important opportunity to deliver the message to European parliamentarians, and I think them hearing from Congress what your priorities are and your interest in doing that would be very helpful, particularly on the regulatory side.

As Congressman Roth points out, clearly the committee structure here doesn't lend itself to an expeditious resolution of regulatory issues as they would relate to an FCC issue, as Mr. Houghton referenced or the FDA, and I think hearing from Congress your inter-

est in spurring this process along on our side would do a lot for them to get their act together.

Chairman GILMAN. We welcome the suggestion.

To what extent has our Nation and the EU and/or member states fully implemented the 1994 OECD recommendations on bribery and international transactions, and what can we do on follow-up recommendations needed in that area with regard to, for example, tax legislation that gives other nations a tax credit for bribery?

Mr. FRENZEL. I have no information on that, Mr. Chairman.

Mr. FARREN. Mr. Chairman, we talked about that. There was a reference in the business community on the need to fully implement the OECD guidelines. I think that is a recognition that they clearly haven't been implemented to the extent we would hope.

Chairman GILMAN. How can we encourage that?

Mr. FARREN. Again, I think sending the message—I was startled having worked on the issue of getting Europeans to accept our standards on foreign practices when I was in the government, I was startled at the number of European businesspeople in Seville who shared that concern, and in fact we did get a recommendation in there which I found quite surprising and there was a very hot discussion which I had an opportunity to sit through in Seville, where European companies actually led the discussion to force the recommendation into the report, which is quite encouraging. But I think the same type of dialogue has to occur with European political leaders.

Chairman GILMAN. Our Commerce Department recently unveiled a report indicating how extensive this bribery is and the losses to our own corporations as a result of it; in the billions of dollars. I think it is something that is quite important.

I want to thank the panelists. I have to attend another meeting and will ask Chairman Roth if he would continue with the discussion.

Mr. ROTH. Thank you.

Chairman GILMAN. Mr. Roth, let me interrupt—regrettably our third witness on Panel 2, Mr. Prestowitz, was unable to attend our hearing today because of the delayed start of our hearing and markup. I would ask that his testimony be made part of the record and that the record be kept open for other statements and submissions related to our hearing topic.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Prestowitz appears in the appendix.]

Mr. ROTH. Without objection.

Mr. Sawyer.

Mr. SAWYER. Mr. Chairman, as a former member of this committee I am grateful for the chance to join you. If Mr. Bereuter is on a tighter schedule——

Mr. ROTH. I was told you want to make a statement. We are broad-minded.

Blast away.

Mr. SAWYER. I am not going to blast away, Mr. Chairman.

I wanted to make a brief statement on my gratitude for the opportunity to take part in this hearing and to thank you for conducting the hearing and the witnesses for being here. The topic is as

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important as any in a changing world where the terms of competition among nations are expressed far more in commercial terms than in military terms. I have argued that I view of the Secretary of Commerce, or whatever that office becomes, as an economic Secretary of State and the work is just that important in defining the relations among nations.

Mr. Houghton raised telecom as one of those technologies that is both a symptom and a driver of change. It is evidence of change and a cause. In a broader sense, it seems to me that intellectual property is similar. While it may not be a good or a service per se, it is a medium of international commerce in a way that it has perhaps never been before. It is particularly important to resolve the differences that we have struggled with over the last several years in terms of intellectual property, and so I would ask whether our witnesses had any comments that they would care to make in that direction?

Before I do, and yield back whatever time you have given me, I just wanted to ask you, Mr. Chairman, when you observed that the Congress was an 18th century institution, why did you turn instantly to Mr. Frenzel, and will he get to comment about it?

Mr. ROTH. He was here——

Mr. SAWYER. It had nothing to do with the depth of his perspective. It is good to see you.

Mr. ROTH. No aspersions intended.

Mr. FARREN. Congressman, your premise on the importance of the economic relationship, I agree with totally. In terms of its impact on the broader relationship, in large measure I think you can view it as reinforcing rods you can find in concrete, because it will hold it together.

I think, particularly in the postwar period, that is probably going to be one of the most important linkages, as you point out. It is probably why we received as much attention as we did from both the Commission and the U.S. Government as the Seville document emerged, because there is a logical reason for them to want to have some means other than political and the macroeconomic questions to really tie the whole process together.

Mr. FRENZEL. I would respond and say that Mike is my spokesman on this matter, but I do want to say, Congressman, other than your nasty observations about my geriatric problem, I wanted to compliment you for your participation in the MEP exchange over the years, and observe as we were talking earlier, the Congress cannot have an interchange with all 180 countries of the world, or however many there are, but if each Member would pick out a couple and be good at them as you have been, I think our country would be better served, and I hope you are going to Europe in January.

Mr. SAWYER. I am.

Mr. ROTH. I appreciate your participation.

Mr. Frenzel mentioned there were 187 countries in the world. I happen to be the congressional delegate to the United Nations this year, and before you came there was a question about when are we going to have a common currency in Europe. Of course, our witnesses had mentioned some time in the future, they didn't exactly know when. I was just giving a speech, and my speech was enti-

tled, "No Common Language, No Common Currency Ever in Europe."

Anyhow, let me turn to Mr. Bereuter, and I thank you Mr. Sawyer for your questions.

Mr. SAWYER. Thank you.

Mr. BEREUTER. Thank you, Mr. Chairman.

I have no questions, but thank our witnesses for their efforts. We have frustrations from time to time. I very much look forward to assisting and working with you as we try to improve our relationship with our European allies on the economic front as well as all others.

Thank you for your good efforts. I appreciate it.

Mr. ROTH. Thank you.

We appreciate having Members like Mr. Bereuter and Mr. Sawyer, because I know they contribute so much. I think the world we are moving into is a different world, it will be a different Congress, and we need people that have a broad perspective like they do.

Why are we going to have a common currency in Europe? I don't believe we are—I don't want to be argumentative, but I have been told at the United Nations we will have 250 countries by the year 2000. It seems the world is—we are getting more and more countries, why would we have a common currency? It would seem we are going in the opposite direction. What am I missing here?

Mr. FRENZEL. Mr. Chairman, I can't tell you. The Europeans have determined or at least the political leadership has determined that a uniform currency will help Europe in its business relationships both within the EU and outside. I look at it like you do. I look at all the political problems, and it seems to me it isn't worth it. And any kid with a hand-held calculator can make change if you ask him to. So I guess I would just say it is their business to make that decision. They have decided a common currency is worth considerable political pain.

I think I remember that when Texas came into our Union, it reserved the right to print its own currency. But so far it has held off, so presumably there is some advantage in using a single currency within a single trading area.

Mr. FARREN. I was going to comment, it is sort of old news now, but I remember as the Commission was preparing for EC–92 and talking about a common currency, then much less realistically or with much less likelihood than they now speak. President Delores at the time was reported as spending a lot of his free time studying the U.S. experience under the Articles of Confederation and the implication toward market integration of the 13 original colonies each issuing their own currency.

He struck upon that, Alexander Hamilton's concept of a linked monetary system of the 13 colonies as one of the principal reasons that the United States was able to come together economically. So it was really a principle adopted very early on in the whole EC–92 and European integration and realistically, particularly when you see the North-South divide in terms of development, if you are going to have interest rates, government finance and it really goes currency valuations, almost down the line, if you are going to have a capital market and capital costs that reflect common social costs

and a common political agenda, then ultimately that is woven together in a common currency.

I think there is a presumption that is the route they have to go and I think inevitably they will get there, not to disagree with your article, Mr. Chairman.

Mr. FRENZEL. But they are doing it the hard way, I agree.

Mr. ROTH. Mao Tse-tung said we didn't change much, maybe a few things around Beijing, but we didn't change much. I was struck by that this summer again when Mr. Frenzel was in Munich and I happened to be there with him, and I was told that this place Alsace was one of the most beautiful places in Europe. I had one of my youngsters with me and we went to the Rhine and took a ferry across and we came to this Alsace where the German language has been outlawed for 50 years and we went there and everybody was speaking German.

So I said to the people: What the hell is going on. They said the thing is, no government can ever change the language people are going to speak. There are some things governments can't do.

I was really struck by that because when I came back to the United Nations and saw the new nations we will have, I said to myself, you are not going to have a common language. You are not going to have a common currency because these are deeply felt things that you are not going to change about government.

One of the reasons I am so concerned about going into Bosnia is because there are things deep down inside that you are not going to change in people. We have a great town over here, Winchester, Virginia. A number of years ago they had a reenactment. Stonewall Jackson only lost one battle, the battle of Kernstown right outside Winchester.

I took my boy over there and we viewed the battle. And in the real battle the Federals out numbered the Confederates by 2 to 1, but in the reenactment the Federals were outnumbered by the Confederates by about 2 to 1. In the real battle the Federals took the high ground and dispersed the Confederates through the Shenandoah Valley. But in this reenactment, when the Federals took the high ground, some kid yelled out, "Damn Yankees," and people began to applaud.

I said to my son, we have been one Nation for 130 years, same language, fought wars together, we are the same people. Yet look how deep these feelings are.

And when I see that or I go to places like Alsace, I say to myself there is something much, much deeper here than the government can address, and I think in the world that we are moving into that is what we have to consider. And that is why I am so interested in sitting down with people like you and the CEO's and others and really having a heart-to-heart discussion about where this world is going, what we can do and how people can influence it so we start singing out of the same hymn book. That is my interest in it.

Mr. FRENZEL. Thank you, Mr. Chairman. That is a good point.

Mr. ROTH. I thank you for your testimony here today.

Mr. FRENZEL. Thank you, Mr. Chairman.

Mr. FARREN. Thank you, Mr. Chairman.

[Whereupon, at 12:55 p.m., the committee was adjourned, subject to the call of the Chair.]

APPENDIX

TESTIMONY OF

DANIEL K. TARULLO

ASSISTANT SECRETARY OF STATE

FOR ECONOMIC AND BUSINESS AFFAIRS

DEPARTMENT OF STATE

BEFORE THE HOUSE INTERNATIONAL RELATIONS COMMITTEE

DECEMBER 14, 1995

ON THE NEW TRANSATLANTIC AGENDA

Mr. Chairman, thank you for the opportunity to testify this morning on the New Transatlantic Agenda (NTA). The Declaration signed by President Clinton and his European counterparts in Madrid December 3 establishes an action-oriented program to extend cooperation between the U.S. and Europe. As befits the breadth of our relationship, the Agenda encompasses a wide range of cooperation -- from diplomacy to law enforcement, from health to the environment and from economics and trade to educational exchange and scientific cooperation.

I would like to focus my testimony on four topics:

- the origins and rationale for the NTA;
- the scope of the NTA;
- key priorities for the NTA; and
- the steps we are already taking to implement the NTA.

Origin

For the last half century, the partnership between the United States and Europe has been a history of successes. Our alliance protected Western Europe and advanced the causes of democracy and freedom throughout the world. The triumph of that alliance is manifest in the end of the Cold War and the end of a Europe divided into rival camps. Together we established international economic institutions and pursued economic policies to promote trade and growth. The success of this effort was unprecedented prosperity which helped ensure political stability and increased our peoples' standards of living.

Yet the very success of our partnership called some of its premises into question. With the military threat posed by the Soviet Union gone, did we need a military and political alliance? With the emergence of dynamic, high-growth economies in other parts of the world, did we need to pay attention to U.S.-European economic relations?

The President has answered both these questions with strong affirmatives. He has worked to align our partnership with Europe to the challenges of the twenty-first century through transforming and enlarging NATO, strengthening the OSCE, developing new relationships with the states of the former Soviet Union, and bringing peace to the Balkans. The United States and Europe must work together to confront threats to the security of our peoples, whether from instability in key parts of the world, from nuclear proliferation, or from international crime and terrorism.

In the economic realm, we already have a $327 billion two-way trade relationship (in goods and services) with the states of the European Union. We also have the largest two-way investment relationship in the world. The participation and agreement of the United States and the EU are necessary conditions to any significant multilateral economic initiatives. Yet the very depth of our economic

relationship presents opportunities for further integration beyond what has been achieved through multilateral initiatives. President Clinton and the leaders of the European Union saw the opportunity to advance the political and economic interests of our citizens through a reaffirmation of the importance of our relationship and a work plan to achieve more. Let me turn now to the scope of the NTA.

Scope of the New Transatlantic Agenda

The Agenda affirms four broad objectives for the U.S. partnership with Europe:

First is our cooperation in promoting peace and stability, democracy and development around the world. We fought two wars in Europe and prepared for a possible third. The United States has a strong national interest in promoting the integration of the European continent on the principles of democracy and free markets. In a time of declining budgets and competing priorities, it is also important that we achieve a truly global partnership aimed at resolving conflicts in troubled areas through preventive diplomacy and at promoting growth in emerging economies through coordination of our development and humanitarian assistance.

Second is our cooperation responding to global challenges. While not the object of traditional foreign policy, many threats to our security and quality of life have transcended national boundaries. President Clinton and Secretary Christopher have recognized that sustained policies to deal with new global threats are now necessary. Problems such as organized crime, terrorism, drug trafficking, degradation of the environment, and communicable diseases cannot be addressed effectively by any one country. We have already taken steps in the G-7 and other fora to increase international cooperation in dealing with these issues. The NTA contains further practical cooperative steps.

Third is contributing to the expansion of world trade and closer economic relations. The integration of our economies has proceeded well beyond that which exists among most countries. Yet we can do more. As advanced industrialized nations, we share many of the same problems and opportunities. We share interests in a multilateral economic system that addresses our concerns. In areas not ripe for multilateral action we can reduce barriers on a bilateral basis. The Agenda calls for cooperation in multilateral action and for bilateral efforts to reduce or eliminate bilateral barriers to the flow of goods and services.

Fourth is "building bridges" between our business communities, our scientists, educators, parliamentarians and others. At root the U.S.-European relationship rests on the relationships among people and institutions throughout our societies, not within

narrow bureaucratic channels. The Transatlantic Business Dialogue (TABD) is an early and successful example of such links as well as a key source of ideas for initiatives in the economic part of the Agenda. As we indicated in the Agenda, we also look forward to working with you on ways that we can enhance parliamentary links across the Atlantic and discuss with you other matters related to our Transatlantic partnership.

The New Transatlantic Agenda is a program for action, not just another call for consultation and coordination. The Agenda's objectives are amplified in a detailed Action Plan which contains over 150 specific items. The Summit Declaration draws from this list to set out the key priorities for action in 1996.

The Agenda is thus a rolling process focused on producing tangible results in the context of twice-annual summits. It does not create a new bureaucracy or some convoluted new structure. Between summits it will be coordinated by a Senior Level Group made up of senior representatives from the European Commission and the EU Presidency, and the State Department. The group is charged with monitoring progress and reporting to the Leaders at each Summit; it will also identify new initiatives for priority action. The trade agenda will be overseen by USTR. Other agencies, as appropriate, will have responsibility for initiatives within their areas.

Key Priorities

As you can see from the Declaration by the Leaders, we have identified a number of priorities for immediate emphasis from among the longer Action Agenda. Let me highlight just a few.

- First, the reconstruction in the former Yugoslavia. We have pledged to participate in a global effort to assist recovery of the war-ravaged regions, to support economic and political reforms, and to nourish new democratic institutions. We expect that the EU will play the leading role in the reconstruction effort.

- Second, supporting the achievement of a just, lasting and comprehensive peace in the Middle East. We are working together to coordinate our assistance programs, further open our markets to Palestinian goods, and end the Arab boycott of Israel.

- Third, in the economic and trade area, our goal is to take practical steps that can result in more open markets and bring closer the realization of a New Transatlantic Marketplace which will create good jobs on both sides of the Atlantic. Specific initiatives include: a joint study on ways to reduce or eliminate barriers to trade; agreements on mutual recognition of product testing and certification; a new agreement on customs cooperation, and a program to collaborate on regulatory issues to promote the development of a Transatlantic Information Society.

- Fourth, we have identified specific areas for cooperation in advance of the Singapore WTO Ministerial. We have agreed on a new negotiating effort to conclude an Information Technology Agreement in line with the recommendations of our business leaders in Seville, to seek new mutually agreed tariff reductions, and to consider acceleration of other Uruguay Round tariff cuts.

- Fifth, we will take additional steps in fighting international crime, drug trafficking, and terrorism. We will create cooperative links between U.S. law enforcement authorities and European law enforcement agencies, including the European Drug Unit and, when established, EUROPOL. We will also jointly support training programs for crime-fighting agencies in Central and Eastern Europe, Russia, Ukraine, and in other newly independent states.

Implementation

As the President remarked after the signing of the New Transatlantic Agenda in Madrid, we are committed to "move beyond talk to action." Achieving agreement on actions of tangible and practical benefits is our goal. The President, Secretary Christopher, and Ambassador Kantor each emphasized the importance of implementation to his counterparts.

In the week and a half since the Summit, we have begun work to implement the initiatives identified in the Declaration. Under Secretary Joan Spero and I have met with officials of the Italian government, which assumes the EU Presidency on January 1, to convey our ideas on implementation and emphasize the importance we attach to a quick start. Deputy U.S. Trade Representative Jeffrey Lang is in Europe this week to seek early initiation of the joint study and progress on trade elements of the Agenda.

On the European side, there are also signs of attention to implementation. Prime Minister Dini spoke to the Italian Chamber of Deputies December 5 -- just two days after the Summit and nearly a month before Italy's formal January 1 accession to the Presidency -- outlining Italy's goals for its term. Implementation of the Agenda along with preparations for the 1996 Intergovernmental Conference (IGC) were listed as key priorities. The European Commission has also communicated to us its interest in setting up an implementation task force composed of Commission, EU Presidency and U.S. representatives. The EU has proposed an early meeting to discuss next steps and a specific timetable for action.

Internally, we are organizing ourselves for implementation. As I mentioned, we are not creating a new bureaucracy for this purpose. We are assuring that the appropriate agencies are taking

responsibility for the priority initiatives and contacting their European counterparts.

Throughout the process we have been in close contact with our business community. The successful conference of U.S. and EU business leaders, which took place in Seville November 10-11, 1995, was an important step in our wider efforts to strengthen our relationship with Europe. We welcomed the precision of the proposals coming out of the conference and incorporated many of them into the Action Plan. We will continue to work closely with the business community, as well as with other interested parties, in implementing the Agenda and in generating additional priorities in advance of the next Summit.

Conclusion

The New Transatlantic Agenda remains a work in progress. Its broad goal of recasting and adapting our partnership with Europe in light of the new challenges of a post Cold War world will be achieved only gradually -- with the inevitable stops and starts. The Agenda is not the sum of our relationships with Europe -- it is an important point of departure for concrete initiatives to strengthen these relationships; it is also a vehicle for developing and implementing new initiatives.

PREPARED STATEMENT OF
THE HONORABLE DAVID ROTHKOPF
ACTING UNDER SECRETARY OF COMMERCE FOR INTERNATIONAL TRADE

BEFORE THE HOUSE COMMITTEE ON INTERNATIONAL RELATIONS
DECEMBER 14, 1995

Mr. Chairman, Members of the Committee:

I am very pleased to be with you today to talk about our evolving transatlantic relationship, the Commerce Department's role in building that relationship, and particularly our role in initiating and following up on the Transatlantic Business Dialogue.

The United States has had, and continues to have, an extremely close relationship with Europe, a relationship that is the underpinning of our global security and our global economic relations. Indeed, the security relationship with Europe has been at the very center of our global relations for a half century, and that relationship has dominated all other aspects of our bilateral relations with Europe. Today, in the post-Cold War era, our relationship with Europe remains exceptionally broad, but rising in importance within the totality of our overall relationship is our transatlantic commerce -- our bilateral trade and investment.

While from a global commercial perspective we must maintain a strong focus on the Big Emerging Markets that contain so much of the world's future economic and trade growth, we must also continue an emphasis on Europe, especially on the 15-nation European Union (EU). The EU is simultaneously the most important market for U.S. companies, our largest global competitor, and our most important partner in sustaining and expanding the global trading system. That is why I am particularly appreciative of the fact that you are holding this hearing today, Mr. Chairman, and I commend you for your initiative.

Europe as a Market

To begin with, Mr. Chairman, let me point out that Europe is our largest global market. The latest quarterly data show our exports to the European Union single market at an annual rate of $129 billion, slightly ahead of exports to Canada, our second-largest market, and more than twice as large as exports to Japan, our third-largest market. The EU is the largest market for 26 of the 50 U.S. states, including such western states as California and Washington.

Propelled by U.S. competitiveness and favorable 3 percent real economic growth in the European Union this year, U.S. exports to the EU in the latest quarter are up 18 percent over the year-earlier period. Our imports from the EU are growing about 8 percent, and our trade balance with the EU is improving rapidly. In the third quarter of 1995, the U.S. merchandise trade balance with the European Union was in deficit at a seasonally-adjusted annual rate of $3 billion -- a $10 billion improvement over the same period a year ago.

Moreover, with sound economic policies, especially those that promote market openness and structural economic change, Europe will remain our most important market for at least the next decade. Estimates by the Department of Commerce's International Economic Policy group (IEP) indicate that with an optimistic economic scenario for Europe, U.S. exports to Europe could grow by $120 billion in the next decade -- doubling their size from today.

The European Union is a $7.3 trillion dollar economy, the biggest outside the United States -- in fact, producing one-third of the world's goods and services outside the United States. The EU's economy grows more slowly than the Asian economies, many of which grow 6-10 percent each year. But because of its huge size, the EU's more modest growth rates translate into huge dollar increases. For example, the European Union's 3 percent real GDP growth in 1995 is a one-year increase of $220 billion. That is like discovering every year a new market the size of Taiwan's -- America's 8th largest export market!

The trade figures, however, portray only part of the story. Most international business is done by investing and producing in foreign markets -- not by exporting. For example, while U.S. global exports of goods and services are about $700 billion, the sales of U.S. affiliates abroad are about $1.6 trillion. Over half of those sales -- $810 billion -- are in Europe. This business is not one-way, and European affiliates in the United States sell close to $700 billion.

The startling fact, Mr. Chairman, is that when the bilateral exports of goods and services are added with the production of U.S. and European companies in each other's markets, transatlantic commerce sums to $1.7 trillion! This is 50 percent larger than transpacific commerce.

Furthermore, America's trade with Europe has been quite balanced. With trade surpluses in some years, and deficits in others, the U.S. cumulated trade balance with the European Union over the past 25 years has netted out to just about zero. During that same time, I have to note, our trade with Asia has amounted to a cumulated trade deficit of $1.3 trillion. This balanced position with Europe prevails not just in trade, but in investment as well. Three million American workers are employed by European affiliates in the United States, while three million Europeans work for U.S. affiliates in Europe.

The European market is among the most open to us, at least in manufactured goods. Upon completion of the Uruguay Round, tariffs on each other's industrial products will average about 3 percent. Investment is also quite open, as is shown by the size of the investment relationship. Even so, the commercial relationship is far from problem-free. We have just spent almost a year participating with USTR and other agencies in negotiating compensation owed American companies because of tariff increases stemming the enlargement of the European Union. The Department of Commerce has been working hard to obtain German compliance with agreements opening up the utilities sector. Audio-visual restrictions are still a problem. According to U.S. industry, standards and regulatory regimes are the biggest remaining impediment to the expansion of transatlantic trade, such as potential aspects of the EU's "eco-labeling" program that, if implemented, could imperil billions of dollars of U.S. paper exports.

These problems are important, and need to be resolved -- but their resolution must be in a way that strengthens the bilateral relationship. We mus avoid a situation in which focusing on individual problems becomes the dominant feature of our relations. Therefore, in addition to devoting time to solving problems, we must also work jointly with the EU in developing a common vision of an even more open transatlantic commercial architecture. We must focus on the goals and activities that form a common glue as well as focusing on solving problems.

Europe as a Competitor

In addition to being our largest market, Europe is also our largest global competitor and a global powerhouse. The European Union's exports (not counting intra-EU trade among the 15 member states) are almost one-fifth larger than U.S. exports. Last year the European Union exported $119 billion to the United States -- 18 percent of our imports from the world. Many people are surprised to learn that the EU's exports to the United States are as large as Japan's exports to our market.

Europe's role as a global competitor can be seen in market after market. The EU has 40 percent of the important Middle Eastern market, while the United States has 13 percent. The EU has 16 percent of China's market, compared to America's 12 percent share. While the United States has a larger share of the Japanese import market than Europe does, the EU's share of the rest of the Asian market is neck and neck with America's -- at 14 percent each.

European exporters are supported with a broad array of government backing, including export promotion support, strong government advocacy, and abundant export credits. The United States, in fact, spends far less than our competitors on export promotion. In 1993, for example, France spent $35 billion, Germany spent $23 billion while the US spent only $19 billion on assisting exporters reach foreign markets. Looking at this from another perspective, for every $1,000 of GDP, the US spends $.03 for non-financial export promotion (advocacy, trade events, counseling, etc.), the lowest compared to the major countries of Europe. The United Kingdom, for instance, allocates about $.25 per $1000 of GDP -- proportionately 8 times as much as the United States!

Aggressive government-to-government lobbying by European and other governments has become problematic for US firms. We estimate that in about 200 separate overseas competitions that have been tracked during the past eight years, US firms lost approximately one-half of these contracts due at least in part to various forms of advocacy by other governments. This foreign government involvement in major project decisions, much of which was on the part of European governments, resulted in some $25 billion in lost contracts for US companies during this period. European and other government efforts to help their firms win export contracts are likely to become even more intense as the stakes in important markets rise, international pressures mount to restrict the use of other techniques to help exporters (such as tied aid or domestic subsidies) and pressures intensify on foreign governments to step up their involvement in commercial sales.

In the near term, the competition -- including competition between governments -- may intensify. Over the next decade, some 150 large-scale capital projects worth nearly $1 trillion are likely to be undertaken, spawning intense competition among international firms and among governments providing support to them. The extent of competition between the U.S. government and European governments in supporting their firms' efforts to win a portion of these lucrative deals could well create hard feelings and tend to push the U.S. and Europe apart.

We must try to avoid this danger, for we cannot afford to have hostility pull us apart and interfere with our joint cooperation. We must accept the fact that we are competitors, but we must all be comfortable with the rules of that competition. The only way to address this problem is jointly. We must ensure that the rules affecting such matters as bribery and corruption, tied and untied aid, and other factors which are relevant to competing for many projects, are jointly agreed -- starting with agreement between the United States and Europe. As I will highlight later in my testimony, European companies indicate that they would welcome firm rules that would tend to place competition more on price and quality factors -- rules that would, for example, include statutes with sanctions against bribery of foreign officials.

Europe as a Partner

While we work toward a mutual understanding on these matters, it is very important in the short term that we place the competitive nature of our transatlantic relationship in the broader perspective, and that we not allow the fact that we are competitors to be the dominant feature of our relationship.

As important as Europe is to us both as a market and as a competitor, perhaps its overwhelming significance is its role as a global partner for America in opening world markets and in shaping the multinational environment. For a half century the United States and Europe have shared a vision of increasingly open world trade, and have cooperated toward the attainment of that vision. Europe has been instrumental as a U.S. partner in every round of multilateral trade talks since the first GATT round in 1947. It is not an exaggeration to state that these market opening moves would not have been possible without the active support and joint leadership of Europe.

All multilateral trade and economic agreements have required our joint leadership, and this has required the United States and the European Union to first reach agreement on the objectives of a multilateral effort and only after this agreement has been reached -- at least in general terms -- has it been possible to provide the joint leadership that has proven necessary to obtain multilateral agreement. The road has sometimes been very difficult, with the United States and Europe unable for long periods of time to reach an agreement. The years during which the Uruguay Round stalled while the United States and the European Union struggled to work out their differences on agriculture is only the most visible of these difficulties.

Little global liberalization can occur without the European Union and the United States first utilizing their partnership and agreeing to take global leadership jointly. Preserving that relationship -- both to secure further market opening across the Atlantic as well as globally -- is an absolute necessity. Were we to focus only on selling into each other's markets and on the problems and difficulties entailed in that effort, we would risk imperiling the cooperative partnership without which, surely , we would see an unraveling of the global trade system.

European Commission Vice President Sir Leon Brittan correctly noted not long ago that "apathy is not enough to support free trade." He is absolutely correct, and we must not allow the partnership between the United States and Europe to be taken for granted. We must actively seek to expand and invigorate that relationship.

Transatlantic Business Dialogue

The Commerce Department has played an extremely active role over the past year in a major -- and highly successful -- effort to reinvigorate the U.S. - European relationship. Building on a basic philosophy of Secretary Brown's, we at the Commerce Department have set as a major objective the earlier and more active involvement of business when it comes to the formulation of goals for U.S. commercial policy. We believe that this involvement accomplishes a number of objectives: first, it is likely to result in better policy decisions; second, it is likely to ensure more robust support for implementing trade and other commercial policy decisions; and third, it broadens the overall base of communication and understanding in building bilateral and multilateral relationships.

It was almost exactly a year ago that Secretary of Commerce Brown proposed in a speech before the American Chamber of Commerce in Belgium the initiation of a Transatlantic Business Dialogue in which U.S. and European business would engage in a dialogue with U.S. and European governments and would develop a business-driven vision and specific recommendations for further improving the transatlantic commercial relationship. The idea was a simple one -- to find out what we should do to improve transatlantic commercial relations, we should go out and ask the people who were actually doing the exporting; actually taking the risks to invest their money; and actually creating jobs. We should, in other words, put the business "horse" in front of the government "cart".

Moreover, we should get business leaders together from both sides of the Atlantic, get them to "roll up their shirtsleeves" and see what mutual problems they have in trade and investment, and what agreed solutions and recommendations they could develop. We were quite sure that a "transatlantic business community" already existed, given the huge size of transatlantic commerce, with thousands of companies producing and selling on both sides of the Atlantic, and facing similar problems regardless of whether they were U.S. - owned or European - owned.

Business enthusiastically agreed with our idea, on both sides of the Atlantic. The European Commission also agreed -- signing on cautiously at first, and then embracing the idea as a strongly positive force. European Commission Vice President Sir Leon Brittan and Industry Commissioner Dr. Martin Bangemann agreed to join the Secretary as co-conveners of the dialogue. Xerox CEO Paul Allaire and Ford CEO Alex Trotman agreed to Secretary Brown's request that they co-chair the U.S. private sector effort; and BASF CEO Dr. Juergen Strube and Goldman Sachs International Chairman Peter Sutherland (also former Secretary-General of the GATT) co-chaired the European business effort. They decided on a major conference, at which U.S. and European chief executive officers would map out a combined transatlantic business-driven agenda with as many mutually-agreed specific recommendations as possible -- and this is the conference that was held in Seville, Spain, November 10-11, 1995.

The conference, and the process leading up to it, set an excellent example for public-private cooperation. Both the U.S. government and the European Commission agreed that as many of the recommendations as possible would be considered at the December 3rd U.S. - EU Summit between President Clinton, European Commission President Santer, and European Council President Gonzales (the Spanish Prime Minister heading the European Council during Spain's turn as President of the Council the second half of 1995).

The Commerce Department's IEP European office worked closely with the business leadership to obtain a diversified U.S. business delegation. The U.S. business delegation to the Seville conference totaled about 60, of which about 40 were CEOs. Notably, about half of the CEOs were from small and medium-sized U.S. firms. This was not a "Fortune 500" event. Nor was it a single agency event. The U.S. government delegation, which was at Seville not to participate in the recommendations, but to engage in a dialogue with the transatlantic business community and to serve as a resource, included Ira Magaziner, Senior Advisor to the President; Reed Hundt, Chairman of the Federal Communications Commission; Sharon Smith Holston, Deputy Commissioner of the Food and Drug Administration; Ambassador Jeffrey Lang, Deputy USTR, and of course our Ambassador to the EU Stuart Eizenstat and to Spain, Richard Gardner.

It was the business leadership, however, that made the event a success The U.S. business community leaders, which included Ford, Xerox, Tenneco, Dresser, AMP, and Westvaco, put in a prodigious amount of time in working with participating companies, trade associations, industry groups, and others to produce a robust set of recommendations for the executives to consider in Seville. The European business community did the same. . Both the U.S. and European conference leaders spent extraordinary amounts of time consulting with each other across the Atlantic, and with the full range of interested companies and associations both in Europe and the United States. The Washington leadership of Xerox, J. Michael Farren, and Ford Motor Company, Charles Becher, deserve special mention for their ceaseless work. It was an "inclusive" process, rather than "exclusive", and it generated widespread interest and support.

The Seville Conference was a remarkable success. The more than 100 U.S. and European business leaders who met in Seville did indeed comprise a transatlantic community, with a common set of problems and able to agree on a broad set of joint recommendations that set a trade agenda for governments. The business leaders took a pragmatic perspective and focused on the actual impediments to their transatlantic business. They did not call for a closed, discriminatory trading area, but rather for additional steps to open markets and remove costly barriers not only to transatlantic trade, but globally as well. Reflecting the key areas of interest that had been jointly identified by both business communities, they developed over 70 recommendations clustered into four areas. I have brought with me today copies of the he Transatlantic Business Dialogue report, and would also like to note that our International Economic Policy group (IEP) has put the text on-line on the internet, where it can be accessed at:

http://www.itaiep.doc.gov

The highlights of the recommendations include:

Standards and Regulatory Issues -- Both business communities saw different standards, approval requirements, and regulatory requirements as the largest remaining transatlantic barriers -- more important than remaining tariffs. They called for quick action for mutual acceptance of standards and product approvals, and for the goal of eventual harmonization. They want governments to open access to standards-setting bodies and called for a joint business-government Transatlantic Standards and Regulatory Advisory Committee to work on these highly technical issues.

Trade Liberalization -- The U.S. and European executives agreed that governments should try to accelerate Uruguay Round tariff cuts, should explore duty elimination in more sectors, and should negotiate by the end of 1996 an "Information Technology Agreement" that would eliminate duties on a broad range of high tech products by 2000. They saw all tariff cuts being done in a WTO-compatible MFN manner.

Investment -- They jointly called for the U.S. and the EU to press for quick negotiation of a multilateral investment agreement, and stressed right of establishment and full national treatment.

Third Countries -- In a move that surprised many, the European executives joined U.S. firms in calling on governments to enact effective antibribery legislation with sanctions and with elimination of the tax-deductibility provisions many European countries allow for foreign bribes. The executives also urged the U.S. and the EU to work together to obtain better intellectual property protection in third countries and for tougher enforcement.

Including the Transatlantic Business Dialogue in the U.S. - EU Summit

The Transatlantic Business Dialogue is a process, not a single conference or a single report. It is a process that began in Seville and that will continue into the future, with the transatlantic business community continuing to work with governments to implement as much of the business-driven agenda as possible.

The first, and extremely important, step in the implementation process was the December 3, 1995, U.S. -EU Summit meeting in Madrid, Spain, among President Clinton, European Commission President Santer, and European Council President Gonzales. They agreed on a "New Transatlantic Agenda" that sets the course for the entirety of the U.S. - European political and economic relationship -- including an Action Plan and the creation of a "New Transatlantic Marketplace," a program that will implement steps to remove remaining obstacles to trade and investment across the Atlantic.

The trade and economic aspects of the Action Plan, including the "New Transatlantic Marketplace," incorporate many of the major recommendations of the Transatlantic Business Dialogue. Some recommendations were included after the conclusion of the Seville Conference, when government officials took an intensive look at the Transatlantic Business Dialogue recommendations. Other of the recommendations had already been incorporated into the advance thinking of the drafters of the Summit documents after reviewing the early think pieces prepared by business participants in the months preceding the Seville conference. Among the major Transatlantic Business Dialogue Recommendations included in the Madrid Action Plan are:

-- Attempt to negotiate and conclude an Information Technology Agreement
-- Explore further industrial product tariff cuts and acceleration of Uruguay Round cuts
-- A commitment to combat corruption and bribery by implementing antibribery legislation
-- Conclude mutual recognition agreements on product approvals, and extend to more sectors
-- Seek transparency, full participation, and non-discrimination in standards-setting bodies.
-- Seek to harmonize vehicle safety and pollution regulations
-- Improve IPR protection throughout the world and intensify efforts in the WTO
-- Strengthen regulatory cooperation
-- Conclude by the end of 1996 a customs cooperation agreement.

The Madrid "Action Plan" covers the totality of the U.S. - EU relationship, so of necessity the Seville recommendations are contained in abbreviated form. Their inclusion in the Action Plan, though, reflects the concurrence of governments that those recommendations should be implemented, and a commitment to begin implementation. The inclusion of these recommendations is a historic event. It marks the first time that an organized approach of U.S. and European business communities to develop recommendations for governments has been included in the action commitments of government leaders.

Moreover, the leaders made it plain that the Madrid Action Plan is but the beginning of a government implementation process. Very importantly, the Presidents agreed that the Transatlantic Business Dialogue was an "integral part" of the summit process and that government officials will work closely with business leaders to consider follow up to the remaining Seville recommendations and will report on progress at the next U.S. -EU Summit. The entire set of Transatlantic Business Dialogue recommendations is, moreover, included by reference as part of the consideration of future actions under the "New Transatlantic Marketplace".

Follow-up

The Madrid Summit's inclusion of, and references to, Transatlantic Business Dialogue recommendations is an excellent beginning. Our task now is to see that the momentum begun at Seville continues, and that we work with business in seeking maximum possible implementation of the business-driven agenda we have been given.

At Seville, in meetings with Sir Leon Brittan, Dr. Bangemann, and other officials, it was clear to me that the Commission and many of the member states were exceedingly pleased with the results of the Seville conference, and viewed the new relationship with European business as one that would help advance a more liberal trade and investment agenda. U.S. trade officials were equally pleased, and are ready to work with the Transatlantic Business Dialogue leadership in the process of adopting the maximum possible number of the recommendations from Seville.

Of immeasurable importance is the continued interest and leadership of Alex Trotman, Chairman and CEO of the Ford Motor Company, who has agreed to continue as the U.S. chairman of the Transatlantic Business Dialogue. His willingness to continue to devote time to working with the U.S. business community and with the European Chairman, Dr. Juergen Strube, CEO of the German chemical company BASF, provides the foundation for the follow up to the Seville conference. His designee in Washington, Mr. Charles Becher, will be providing the day-to-day coordination of the private sector's work with government officials in the follow up process.

The Commerce Department's role will continue to be that of a catalyst. We have already begun discussion within the U.S. government on how to work with business in the context of the State Department - led planning process for the next U.S. - EU Summit and the USTR - led process of looking at the trade agenda to provide the substance for the New Transatlantic Marketplace.

Our next step will be a joint U.S.-European Transatlantic Business Dialogue steering committee meeting with U.S. and European business and with the European Commission, planned for the end of January. We will focus on how the business community on both sides of the Atlantic can work most closely with government officials in examining the remaining recommendations. An important aspect will be determining how to implement a key recommendation yet to be adopted from the Seville conference: the formation of a Transatlantic Advisory Committee on Standards, Certification, and Regulatory Policy made up of U.S. and EU representatives of government bodies and industry to provide guidance and monitor progress in achieving reform and in these areas. Additionally, the steering committee will begin considering when would be the best time for a 1996 follow-on conference of U.S. and European business leaders.

We are also working with business on plans for sectoral meetings to find additional common ground. The first of these will be in the automotive sector, where we are working with U.S. and European industry, the European Institute, the European Commission, and the European Parliament for a conference to be held in Washington in April 1996 to explore harmonization of automobile safety standards, testing, and pollution and noise requirements in a way that maintains consumer protection while lowering costs. Secretary Brown will be seeking full participation from appropriate government agencies, and we hope for Congressional participation as well.

Additionally, we look forward to a broader dialogue with the Congress, joining with the private sector leadership of the Transatlantic Business Dialogue to inform key congressional committees of the business recommendations, and to attract their interest in helping to open Transatlantic commerce further.

Europe Beyond the EU

While the focus of today's hearing is on U.S. - EU relations, I would be remiss if I did not mention our strong commercial interests in the rest of Europe and their relationship to the European Union. The EU is not only the central feature of the European economy, but also is a magnet attracting the rest of the European economies. Even countries such as Switzerland and Norway, which have opted not to join the EU formally, are included in wide-ranging economic agreements providing such economic linkages as duty-free trade in manufactured goods.

Central and Eastern Europe -- The EU's association agreements with the countries of Central and Eastern Europe are particularly notable in their relationship to the political and economic stability of those reforming economies. The success of the reforms in the Central and Eastern European economies is critically dependent upon the restoration of strong economic growth, and rising standards of living. These economic objectives, in turn, depend upon rapid expansion of two-way trade with the West and sharp growth in Western investment in the region.

Central and Eastern Europe is going to be one of the world's growth markets; but it is already a market much larger than commonly thought. The region -- with 120 million people -- is now a market worth over $500 billion. It is poised for solid growth, that Commerce's IEP European Office estimates will average at least 5 percent annually. That means that within a decade the market will be about $900 billion -- a $400 billion increase in the next ten years!

The economic turnaround is already occurring. After falling 25 percent between 1989 and 1993, the region's real GDP grew 3 percent in 1994 and about 4 percent in 1995. Structural reforms and stabilization policies are beginning to show results. Private sectors in most of the region's major economies now account for about two-thirds of GDP, a remarkable transformation in just five years. Inflation is slowing, though it is still a problem.

The Polish economy -- largest in the region, and one of the 10 Big Emerging Markets the Administration has identified globally -- is in its third year of accelerating economic growth. It grew 4 percent in 1993, 5 percent in 1994, and looks like it will grow 6 percent in 1995. Its industrial production is now growing at an annual rate of 10 percent, among the fastest in Europe.

To attract more U.S. companies to the market, the Department of Commerce has a variety of tools. Prime among them is the Poland Big Emerging Market Program, in which we are undertaking a variety of activities, including fairs and missions. A major informational program is also a part of our activities -- for many U.S. companies are simply unaware of the prospects for doing business in Poland and in the region. We have established, with help from U.S. assistance program funds, a Central and Eastern Europe Business Information Center (CEEBIC) that responds to 35 thousand U.S. business inquiries a month through its phone, fax, and internet information services.

U.S. companies are already the leaders in investing in Central and Eastern Europe. American firms have been quicker than European companies to realize the investment potential of the region, and are the largest investors in Central and Eastern Europe -- accounting for about one-third of the total foreign direct investment in the region. Germany, the second-largest foreign investor, accounts for about 20 percent. Total investment into to the region, though, is still small. The $18 billion stock of foreign direct investment in Central and Eastern Europe at year end 1994 was only 3.6 percent of the region's GDP -- much less than its potential. Hungary, which has attracted almost half of the foreign investment into the region, provides an example of the potential. The $8 billion stock of foreign direct investment in Hungary at year end 1994 was equivalent to 14 percent of Hungary's GDP. If that rate had prevailed throughout the region, investment would have been $70 billion -- four times as large as the actual stock of $18 billion. This disparity highlights the fact that the investment and commercial climates of the region, while improving, need further improvement.

Seeking further improvement in the commercial climates of the countries in the region was a focus of the White House Conference on Trade and Investment in Central and Eastern Europe convened by President Clinton last January in Cleveland, Ohio. It is also why Secretary Brown will host the fourth West-East Conference of Trade and Economic Ministers (the "Muenster Conference" -- after the city in which it was originally held) in Baltimore this coming January. Secretary Brown will continue efforts to decrease the barriers to trade and investment and to build governmental support for private partnerships in the region.

Turkey -- Finally, I would like to say a few words about Turkey, which along with Poland, is one of the two Big Emerging Markets in Europe. The European Parliament just yesterday voted to enter into a customs union with Turkey, effective January 1st, 1996. This historic and crucial vote will help cement Turkey more closely into the mainstream of economic development and global commerce, and help stabilize the economy of one of the most strategically vital allies for the United States in that part of the world. Turkey is taking an enormously important economic step in forming a customs union with the European Union.

This customs union will lower most Turkish tariffs on American imports to the level of the European Union's Common External Tariff -- meaning that as the Uruguay Round tariff reductions are phased in, Turkish duties on U.S. manufactured goods will average only about 3 percent. This is a major positive change posing great opportunities for U.S. firms -- especially in that Turkey's other import fees, such as the "mass housing fee" that imposed an additional 15 percent or more import charge on U.S. products -- will be eliminated.

The customs union also poses a competitive challenge in that American companies will be faced with a situation where their EU competitors will enter the Turkish market duty-free, though in many industries the differential will be small or non-existent. Moreover, the structural pressures that the customs union will place on Turkish industry will require Turkish firms to implement considerable changes, and will lead to opportunities for American firms to supply production technologies that will enable Turkish firms to become world-class competitors. Many U.S. firms have long recognized that Turkey, with its geographic linkage of Europe, the Middle East and the southern tier of the former Soviet Union, is a natural market for U.S. business.

Turkey is a pro-Western, market-oriented and important democracy in a region which has few democratic traditions and where Islamic fundamentalism is increasing. Turkey continues a close security relationship with the United States in the post-Cold War era, and a growing economic relationship. With nearly $3 billion in exports to Turkey, the United States is Turkey's second largest supplier, after Germany. Over the past decade, Turkey has had the highest average real GDP growth rate of any OECD country. Its demographics, dynamic private sector, extensive infrastructure requirements, EU customs union membership and government commitment to liberalize the economy are expected to sustain continued economic expansion into the 21st century.

The United States will continue to work closely with Turkey to encourage continued economic growth in Turkey, and to expand bilateral trade and investment. Secretary Brown will be visiting Turkey in January 1996 to discuss business cooperation, advocate for U.S. companies in some major projects, and implement steps to improve the bilateral business and government dialogue.

Concluding Remarks

Mr. Chairman, I would like to conclude my remarks by stressing again the crucially important nature of our relationship with Europe, and the central role trade and investment play in that relationship.

Europe's economic health is of great importance to the United States. For example, one percentage point higher average European GDP growth would mean that U.S. exports a decade from now would be $50 billion larger than otherwise -- with over 800 thousand additional U.S. jobs. The U.S. competitive position in Europe is also highly important. Each one percentage point change in the U.S. share of Europe's imports means $14 billion of U.S. exports annually -- equivalent to over a quarter million U.S. jobs. Europe's cooperation and joint leadership in maintaining open markets globally and its interest in working with us for further global liberalization are essential to our economic position around the world.

Hence, as we allocate the U.S. government's time in strategic, commercial, and other considerations, we must continue to give a high priority to Europe. We need a clear vision for the future, one in which security, economics, and global cooperation are seen of equal dimension. I believe, Mr. Chairman, that the two events in Spain in the last 40 days -- the Transatlantic Business Dialogue in Seville, and the U.S. - EU Summit in Madrid, have given us an excellent beginning toward that vision of the future, and our task now is to convert that vision into reality. Your hearings today are an important step in that process.

Thank you, Mr. Chairman.

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Governmental Studies Program
Bill Frenzel

Dec. 14, 1995

House Committee on International Affairs
The Honorable Ben Gilman, Chairman

US-European Relationships Following the Seville Transatlantic Business Dialogue and the Madrid Summit of 1995; Is there a TAFTA in our future?

Mr. Chairman:

Many thanks for allowing me to present some thoughts on this subject. They are, of course, my own, rather than those of the Brookings Institution.

Based on the directions of your excellent Staff, I shall address the relationships between the U.S. and the European Union primarily from a Commercial standpoint, and secondarily, from a Political standpoint. I would be pleased to talk about Security as well, but it is neither my long, nor my strong, suit.

This paper is only an outline of my presentation, and I would therefore ask unanimous consent that my oral testimony be made a part of the record following this paper.

I. Background
  A. TPN European Strategy
  B. US Reaction
  C. US Business Enthusiasm
II. Bureaucrats and Elected Officials
  A. E.U.
    1. European Commission
    2. National Leaders
    3. Spanish Presidency
  B. U.S.
    1. Secys. Christopher and Brown
    2. Others; USTR, NSC, etc.

III. Transatlantic Business Dialogue

A. Sponsors: Brown, Bangemann and Brittain

B. Cheerleaders: American and European Businesspeople

C. Preparation

1. Working group divisions
2. Industry leaders
3. Pre-Conference meetings and cooperation

D. Meeting; Conclusions

IV. Madrid Summit (Santer and Clinton)

A. Commercial agreements based on TBD Conclusions (III. [D.] above)

1. Variations

B. Negotiations completed relatively easily and early

C. Reports

1. Action Plan (long form)
2. New Transatlantic Agenda (short form)

V. Role of the Congress

A. International Policy has languished in 1995

B. European friends concerned

1. Time Magazine of 10-30-95
2. Extraterritoriality

B. There are important opportunities in Europe

1. Economic; see Agenda, Action Plan, and TDB Conclusions
   a. New Transatlantic Marketplace
   b. OECD INvestment Agreement
   c. WTO; Services, Procurement, Tariffs, etc.
   d. Regulatoy Cooperation, Competition, Testing and Certification, Customs, Communications & Information
   e. And lots more

C. Other Political (Non-Trade) Opportunities

1. Security
2. Crime, Drugs, Terrorism, Refugees, Health, Environment

D. Assist the Administration on Action Plan items where you deem it appropriate

E. Counsel with Business advisors as to timing and priority of Commercial matters

1. Businesspeople participating in TBD, TPN and lots of other organizations are uncharacteristically well organized on this matter
2. They would love to get your attention

F. There may be a TAFTA in our future, but it won't come suddenly

To sum up, Mr. Chairman, in Trade matters, as in Politics, Vince Lombardi's advice, i.e. "Run to daylight", is often appropriate. Because of the TBD and the Madrid Summit, there is daylight across the Atlantic. None of the short term agenda contemplated at the Summit requires Legislative enactment. Other developments must succeed before a TAFTA can follow. However, all that was contemplated at Madrid needs the attention and, hopefully, the encouragement of this and other Committees of the Congress.

In the Commercial areas, we are being led by our businesses (not merely Washington Reps, but CEOs, senior officers, and Board members), but Congress must signal approval to make things happen. In Security matters, and in other political matters (V. C. 2. above), I would hope that the Congress would be the leader.

Mr. Chairman, important opportunities lie to the East where we have our oldest and strongest relationships. I am delighted that this Committee has taken a strong interest.

Testimony of
J. Michael Farren
Vice President
Xerox Corporation
on the
Transatlantic Business Dialogue
before the
House Committee on International Relations
Washington, D. C.

December 14, 1995

Mr. Chairman, I am pleased to be able to offer my perspective on the Transatlantic Business Dialogue (TABD) and the implications of the process that was initiated in Seville, Spain on November 10 & 11. First allow me to explain that my role in the Dialogue was to support Mr. Paul Allaire, CEO of Xerox Corporation, in his capacity as Co-Chair of the U.S. business delegation. Mr. Allaire shared that responsibility with Mr. Alex Trotman, CEO of Ford Motor Company.

The report issued at the conclusion of the Seville conference, which is entitled "Transatlantic Business Dialogue Overall Conclusions" spells out in detail the recommendations agreed to by the approximately 100 business leaders in attendance. I do not intend to take your time to restate the nearly 70 recommendations and have brought copies of the report that could be included in the record of this hearing.

I would like to take the time available to me today to comment on the implications of the Dialogue on the business community and the transatlantic marketplace. The prime accomplishment of the Dialogue was the astonishing success of the business leaders in arriving at common conclusions and creating a comprehensive document. The document offers specific and meaningful recommendations that truly constitute a business led agenda for the creation of a new transatlantic marketplace.

A valuable by-product of the Dialogue was the ability and necessity of the U.S. and European participants to organize themselves and establish priorities that reflect the common interests of the transatlantic business community. We wanted the recommendations to reflect the priorities of a single transatlantic business community rather than the fractured views of two disparate communities separated by conflicts more divisive than the Atlantic itself. We sought to avoid an atmosphere of bitter negotiations and create a sense of partnership. The participants succeeded in addressing issues and recommendations as a single business community linked by a common interest in removing the remaining government impediments to trade.

The experience of both the U.S. and European participants offers a model for future efforts to forge a business agenda of common interest. The follow-up

process will be a lesson in advocacy as business presses for government implementation. It will also be a difficult ongoing task to keep the recommendations current and relevant.

The Seville recommendations constitute an amalgam of sectoral issues and goals. Seville demonstrated that sectoral issues can be combined into a broader transatlantic business agenda and provide a synergy that accelerates overall implementation. The follow-up is reliant on individual sectors energetically pursuing their specific objectives and serving as a catalyst to eliminate broader market-wide restrictions

The business community must maintain the cohesion of interests reflected in the Seville conclusions and the governments need to take prompt and tangible steps to implement the recommendations. Seville illustrated the role that the marketplace and business can serve in supporting the overall political and economic transatlantic relationship. The approach taken by the business leaders in formulating recommendations demonstrated their commitment to the World Trade Organization (WTO) and the multilateral trading system. The benefits of a stronger U.S. - EU marketplace will ultimately be shared by the nearly 130 WTO members.

The Madrid Summit on December 3rd was an appropriate first step to implement the Seville recommendations and in keeping the Transatlantic Business Dialogue underway. The Presidents called the Dialogue an "integral part" of the Action Plan that was adopted in Madrid. They called for appropriate government officials to work closely with business on the implementation of the recommendations. Specific aspects of the recommendations were also cited by the Presidents. Most importantly, the Presidents called on governments officials to report at the next U.S.-EU Summit on the progress made in implementing the Seville recommendations.

It was a clear signal that business can spur the governments to act provided our positions are concise, specific, and reflect the consensus of the transatlantic business community. Taken together, the Seville recommendations, the process of business community cooperation that took form in Seville, and the Madrid Summit's Action Plan provide a unique opportunity to significantly accelerate the integration of the transatlantic marketplace.

Alex Trotman, CEO of Ford Motor Company and Jurgen Strube, CEO of BASF have volunteered to Co-Chair the follow-up process through 1996. The Co-Chairs will identify the best means to press for the implementation of the recommendations, continue the dialogue on issues that need further consideration,

and arrange a follow-up meeting in the U.S. in 1996. We have been most encouraged by the enthusiasm of those who attended Seville to keep the process moving.

That process needs the active support of national governments. Our European business counterparts have the difficult task of taking the message beyond Brussels and the Commission to the fifteen national governments. On the U.S. side we will need the help of Congress, the Administration, and just as importantly the support of regulatory agencies.

We are grateful for the role that our government officials have already played. Secretary Brown initiated the Dialogue through his initial proposal to the EU Commission and the Commerce Department led an interagency effort to convene the Seville conference and support the business participants. High level officials from Commerce, USTR, State, the FCC, FDA and other regulatory agencies attended the Dialogue. The government participants in Seville did what does not always come naturally to many in government, they listened. Following Seville, the Administration made every effort to have the Dialogue's recommendations incorporated into the Madrid Summit's Action Plan.

To close, I can best summarize the view of business by referencing the statement adopted by the participants in the Dialogue at the conclusion of the Seville conference: "The U.S. and European business leaders meeting in Seville are determined to take this process further. Action is needed to liberalize trade and investment, to remove public policy impediments to the operation of the market and to encourage cooperation on wider international issues. Such action will do more than almost anything else to build prosperity and create jobs."

Thank you.

FACT SHEET

The "New Transatlantic Marketplace"

The U.S. and EU have pledged in the New Transatlantic Agenda to create a "New Transatlantic Marketplace" in which barriers hindering the flow of goods, services and capital are reduced or eliminated. We anticipate the New Transatlantic Marketplace will set a standard for liberalization of trade barriers and regulatory harmonization that will invigorate the global economy.

Of the many specific initiatives set out the Joint Action Plan, there are several of particular importance. The U.S. and EU have agreed to conduct a joint study of ways to facilitate trade in goods and services and further reduce or eliminate tariff and non-tariff barriers. We will also make a high-priority push for agreement on the mutual recognition of product testing and certification, and seek to foster greater regulatory cooperation to promote greater compatibility in standards and health and safety measures. The U.S. and EU will conclude a Customs Mutual Assistance Agreement that simplifies customs procedures and improves data retrieval and exchange. We will, moreover, work to promote connectivity and competitiveness in telecommunications, with the goal of developing a Transatlantic Information Society.

The U.S. and EU have also pledged to build a stronger multilateral trading system and reduce barriers to global trade. In this respect, the U.S. and EU have agreed to launch a new negotiating effort aimed at concluding an Information Technology Agreement to reduce or eliminate tariffs and non-tariff barriers in this cutting-edge sector. We will also try to find additional, mutually-satisfactory tariff cuts in other sectors, and to consider which, if any, of the Uruguay Round tariff cuts can be implemented on an accelerated basis.

The result of these initiatives will be to give a new dynamic to the multilateral trading system in the run-up to the Singapore WTO Ministerial next year. Our leading global trading partners will be fully involved in making these job-creating initiatives a reality, with all agreed tariff cuts implemented on a Most Favored Nation basis.

The Transatlantic Business Dialogue plays an important role in this critical area of U.S.-EU relations. Its meeting in Seville on November 11-12 resulted in numerous recommendations which were incorporated into the Joint Action Plan. The ambitious goals of the New Transatlantic Marketplace will require the active support and interest of the private sector on both sides of the Atlantic. We are committed to staying in close contact with our business communities in order to ensure that the development of a closer and ever stronger transatlantic business relationship remains at the core of the New Transatlantic Agenda.

TESTIMONY OF CLYDE PRESTOWITZ, Jr.

PRESIDENT, ECONOMIC STRATEGY INSTITUTE

HOUSE COMMITTEE ON INTERNATIONAL RELATIONS

December 14, 1995

Good afternoon, Mr. Chairman and members of the House International Relations Committee. I commend you for holding hearings to explore the critical, but frequently overlooked topic of the United States' trade and economic relationship with Europe.

For a number of years now, the United States has been afflicted with something approaching a Pacific frenzy. Recent efforts to form something like a Pacific Basin Free Trade Area through the Asia-Pacific Economic Council (APEC) is only the most visible manifestation of this thinking. Numerous books and popular articles have appeared touting the enormous benefits of U.S.-Asian trade and economic ties. Articles in leading business publications warn American businessmen that if they are not active in the Pacific they run the risk of becoming uncompetitive globally.

Of course, there is a measure of truth in these exaggerated claims. Asia is an important trading partner, and it would be foolhardy to ignore Asia. Yet Asian countries have accounted for the vast majority of the U.S. trade deficit during the past decade. Japan and China alone accounted for almost two thirds of the total U.S. trade shortfall in 1994. These deficits have remained large because government controls, private-sector collusion, and complex distribution systems across the Pacific have interfered with macroeconomic forces. As a result, U.S. exports of manufactured products to many Asian countries, including Japan and China, are much lower than expected, especially given the improved productivity of American businesses.

The U.S. economic relationship with Europe, on the other hand, is strong and mutually beneficial. At the core, the United States and Europe share the same open market, free trade economic philosophy. There are certainly differences between the United States and Europe, but those differences appear insignificant when either U.S. or European economic philosophies are compared with Asian views.

Further, the United States and Europe are each other's major source of foreign direct investment. Despite sectoral disputes, Europe is a prime market for U.S., leading-edge manufacturing industries, such as telecommunications equipment, aircraft, and computers. Overall, trade between the United States and Europe is relatively free -- outside of a few protected sectors -- and behaves as would be expected in response to macroeconomic forces.

The stark contrast between Europe and Asia was driven home to me several weeks ago when I attended both the Trans-Atlantic Business Dialog meeting in Seville, Spain and the APEC meting in Osaka, Japan. Though it received scant attention in the press, the Seville meeting set an aggressive U.S.-European trade agenda that included elimination of tariffs, opening government procurement markets, and working toward harmonizing technical standards. A true free trade agenda was put forth.

In Osaka, on the other hand, many of APEC's Asian members seemed bent on frustrating and delaying movement towards free trade. The talk among Asian countries of finding an "Asian way" to proceed, and their preference for "voluntary" commitments instead of true market opening, signaled that Asia is not really serious about using the APEC process to craft a true free trade arrangement -- at least as that term is understood in the United States.

In short, if the United States is truly seeking to expand markets and enjoy the benefits of free trade, it should be looking to Europe instead of Asia. When the United States and Europe talk free trade, they are talking about the same concrete set of issues. When the United States holds same conversation with Asia, it is unclear that enough assumptions are shared to make the effort productive for either side.

Further, despite the talk of the Pacific Century, the benefits of an Atlantic focused trade strategy are substantial. The Economic Strategy Institute (ESI) completed a study a few months ago that projected the trade gains from a Trans-Atlantic Free Trade Area or TAFTA at $70 billion over seven years with a total boost to U.S. GDP of $42 billion.

Of course, no major trade negotiation is easy, but a TAFTA is a far more realistic negotiating objective than a similar Pacifies Basin effort. The United States cannot and should not ignore Asia, but neither can it afford to ignore its traditional trading ties with Europe. We may indeed be at the beginning of the first Pacific century, but we are certainly at the beginning of America's sixth Atlantic century.

Mr. Chairman, I have brought with me a copy of the ESI analysis of a TAFTA and a recent publication titled "Shrinking the Atlantic" which compares the U.S. economic relationship with Europe to that with Asia. I ask that both of these publications be included in the hearing record.

The Case for a Transatlantic Free Trade Area

Clyde V. Prestowitz, Jr., Lawrence Chimerine, Andrew Szamosszegi

The absence of a transatlantic free trade area and of any high-level push by the United States and the 15-member European Union (EU) to create it is a great mystery of modern international economic affairs. The two regions are officially studying the issue, have already signed an agreement on competition policy, and have initiated a Transatlantic Business Dialogue. But these modest efforts contrast in particular with Washington's high-profile campaigns to negotiate a North American Free Trade Agreement (NAFTA) and to liberalize trade and investment in the Pacific Rim through nurturing the Asia Pacific Economic Cooperation (APEC) forum. They contrast as well with a powerful worldwide trend toward regional or bilateral free trade areas (FTAs).

A Trade Policy Natural

Compared with the NAFTA and the APEC process, a Transatlantic Free Trade Agreement (TAFTA) is a trade policy natural. Unlike the two aforementioned initiatives, a TAFTA would link countries that are already at comparable levels of socioeconomic development and already share a strong commitment to free-market practices. Thanks largely to this common ground, as well as to deep cultural affinities, economic relations between the two regions represent the world's greatest combined two-way flow of goods, services, capital, and technology. Indeed, due to the balanced nature of these economic flows, the U.S.-EU economic relationship stands as a model of mutually beneficial international commerce.

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Ironically, the very strengths of U.S.-EU economic ties are sometimes cited as an argument against seeking a TAFTA. "If it ain't broke, don't fix it," suggest some critics, pointing in the process to already low average tariff levels. Indeed, they add, TAFTA negotiations could highlight those issues still dividing the United States and the European Union, for example, over agricultural trade or subsidies for the civilian aviation industry, and increase tensions.

Others contend that Europe's relatively slow recent economic growth and continuing competitiveness problems would sharply limit the incremental gains likely from a TAFTA. And concerns are expressed that such an agreement might undermine the fledgling World Trade Organization (WTO) and slow progress toward global trade liberalization.

Yet these difficulties pale before the potential gains and the urgency of significantly deepening and institutionalizing transatlantic economic integration. True, the United States and the European Union already trade with each other profitably and extensively. Yet the very volume of trade flows means that even the modest percentage gains that would result from eliminating not only tariffs and quotas but non-tariff trade barriers (NTBs) such as environmental or health regulations with trade-impeding effects would yield sizable absolute gains in economic activity.

For this reason, a TAFTA would put both economic growth and trade expansion in both the United States and the European Union on significantly higher trajectories by the year 2000. Eliminating barriers to trade across the Atlantic could boost economic output in the United States by $142-$239 billion (or between 1.6 and 2.8 percent of GDP) and in the European Union by $94-$184 billion (or between 1.0 and 1.9 percent of total EU output). In other words, a TAFTA would add another Finland-sized increment of economic activity to the EU. Two-way trade between the United States and the European Union could increase between $70 and $100 billion annually between 20 and 30 percent by the century's end, with each region enjoying about the same amount of increased exports.

Just as important, a TAFTA could help reduce or eliminate threats to the continued health of U.S.-EU economic relations stemming largely from the changing relative importance of

economic and security issues resulting from the end of the Cold War. The future of U.S.-European economic relations and of the broader transatlantic relationship may depend heavily on creating the economic equivalent of the kinds of institutions and arrangements that preserved Western unity during the tension-filled Cold War era. TAFTA would represent a major step toward that vital goal.

Far from weakening the WTO and the multilateral trading system, a TAFTA could significantly strengthen both by creating a powerful alliance among nations committed to market-oriented economic practices. This grouping is needed to deal constructively with a series of increasingly contentious trade issues left over from the recent GATT Uruguay Round talks. In fact, the road to greater global economic integration shaped by values and policies that reinforce liberal, free-market principles may well run through a TAFTA. In the absence of a TAFTA, the rules of trade and investment in the next century may well be influenced disproportionately by countries in Asia and elsewhere that have different values, different economic structures, and different views on many key trade issues than the United States and the European Union. This development would represent a major setback for U.S. and European interests.

The Most Important Economic Relationship in the World

Despite the attention recently focused on U.S. trade with the rapidly growing East Asia Pacific region, the overall U.S.-EU economic relationship remains by far the world's most important.

The two largest economic entities in the world (with a combined output of about $13 trillion or some 55 percent of the world economy), the United States and the EU-12, sent $214 billion worth of merchandise and another $100 billion worth of services back and forth across the Atlantic in 1994. As of the end of 1993, the accumulated cost value of their two-way investment flows stood at some $540 billion and was roughly evenly divided between U.S. investment in Europe and European investment in the United States.

Although transatlantic trade flows comprise less than 20 percent of each entity's global trade, investment pushes the U.S.-EU economic relationship into the global top spot. European firms account for nearly 60 percent of all foreign direct investment in the United States (compared with only 26 percent for all Asian firms) while U.S. FDI in Europe represents nearly 50 percent of America's world total (versus the 16 percent currently of U.S. FDI in Asia). And even during Europe's recent recession, U.S. investment in the Continent grew by more than $54 billion more than twice as fast as U.S. direct investment in booming Asia.

In addition, of the $1.5 trillion in sales generated by U.S. overseas investment in 1993 (the latest year for which complete statistics are available), $810 billion came from Europe. European entities, moreover, spent more than five times what their Asia counterparts spent on research and development in the United States. And U.S. firms still form many more strategic alliances with European than with Asian firms.

A Two-Way Street

Transatlantic commerce is not only greater than trans-Pacific commerce, it is far more evenly balanced. The U.S. merchandise deficit with the 15 European Union countries jumped from $7.8 billion in 1993 to $16 billion in 1994. But thus far in 1995 the deficit declined due to an economic rebound in Europe and the weak U.S. dollar. Even more important than the U.S.-EU trade balance at any given time is the balance's tendency to fluctuate in tandem with changes in relative growth rates, exchange rates, and other macroeconomic forces just like economic theory stipulates trade should work.

Further, U.S.-EU imbalances pale into insignificance compared with the $120 billion deficit run by America with East and Southeast Asia in 1994, a figure likely to rise higher this year. Moreover, the long-term trends diverge strikingly. From 1980 to 1994, the United States accumulated fully $1.25 trillion in trade deficits with the rest of the world. Asia accounted for $882 billion of that total (more than two-thirds); the EU accounted for only $10 billion. Further,

the Asia deficits have persisted despite significant fluctuations in relative growth rates and wide swings in exchange rates.

Worse, the composition of U.S.-East Asia trade compares unfavorably with the composition of U.S.-EU trade. America's deficits with Asia are heavily concentrated in core manufacturing industries central to the nation's hopes for future security and prosperity, such as metalworking machinery, power generation equipment, road vehicles, industrial machinery, office machines and computers, and telecommunications equipment. U.S.-EU trade in these sectors is much more evenly balanced. Indeed, in 1994, 90 percent of EU exports to America were manufactured goods, and 85 percent of U.S. exports to the EU fell into this category.

The Macroeconomic Impact

Not withstanding the levels of transatlantic commerce already reached, there is considerable potential for further trade expansion. Even after the tariff cuts agreed to in the Uruguay Round are fully implemented, the European Union will still impose average tariffs of 6.36 percent, while American tariffs will average 3.19 percent, according to Jeffrey Schott at the Institute for International Economics. Major tariff peaks are found in industries such as textiles and apparel, semiconductors, and, of course, farm products. The European Union, moreover, maintains significant subsidy programs in agriculture, commercial aircraft, and other sectors. Both regions limit foreign participation in government procurement. In addition, exporters on both sides of the Atlantic face numerous trade barriers in the form of different testing and certification requirements, customs procedures, environmental and food safety regulations, and competition policies.

The best way to estimate the potential economic impact of trade agreements is to use a bottom-up approach, in which effects are projected on a sector-by-sector basis. Such an analysis would examine the specific provisions of the agreement that affected each sector plus conditions within each industry, relative competitiveness across countries, and other relevant factors.

Unfortunately, a bottom-up approach is beyond the scope of this short paper and it was necessary to make a top-down macroeconomic analysis.

In so doing, several simplifying assumptions were made. First, it was assumed that exchange rates would be unaffected by a TAFTA because of the balanced impact on trade flows that could be expected from reducing barriers in both regions to the same levels. Second, it was assumed that the provisions of a TAFTA will apply to trade only between the two regions and will not be extended on a most-favored- nation (MFN) basis. Third, the estimates presented are based on a TAFTA between the European Union and the United States, rather than all NAFTA countries. A broader TAFTA including Canada and Mexico would likely increase the trade flows and GDP gains presented below by approximately 15 percent.

This analysis starts with the current level of two-way total U.S.-EU trade in goods and services some $350 billion annually. It also holds that the only practical way to negotiate a TAFTA would be to seek comparable cuts in trade barriers and thus create similar effects on both sides of the Atlantic. Since bilateral trade flows are nearly balanced in size and composition, it is assumed the agreement would have no independent effect on the trade balance between the two regions. Estimates were derived by assuming that all tariffs would be eliminated, and by adding an estimate of the increased trade that would result from bringing down NTBs. Making these assumptions, transatlantic trade liberalization would produce similar increases in U.S. and EU exports, creating about $35 billion in extra exports for each region, an increase of some 20 percent.

A $35 billion increase in U.S. exports is entirely consistent with reasonable assumptions about the impact on prices of the elimination of tariffs (which are easy to quantify) and of NTBs (which are more difficult to quantify), and with the range of price elasticities routinely applied to such price reductions. The Economic Strategy Institute estimates the impact of NTBs on trade flows is two to three times larger than the effect of tariffs, a range consistent with U.S. Department of Commerce estimates. This assumption is also supported by anecdotal evidence: business communities on both sides of the Atlantic claim discriminatory government procurement

practices, business subsidies, restrictions on direct investment, product standards, and countless sector-specific barriers in both regions cost exporters billions of dollars in lost sales annually. For the purpose of this exercise, an elasticity of about 2.5 was applied to tariffs on manufactured goods, and an elasticity of a little less than two was applied to other tariff cuts, and to the price equivalent of all NTBs. These elasticities incorporate the sum of trade diversion (for instance, substituting U.S. exports for Japanese exports in Europe), displacement of domestic production, and the incremental demand that would occur in response to price cuts flowing from eliminating tariff and non-tariff barriers.

The Impact on Economic Growth

In addition to the 20 percent increase in two-way transatlantic trade, trade liberalization can be expected to have a number of growth-enhancing effects, increased efficiency (which occurs when output shifts from relatively low-productivity industries to relatively high-productivity industries and when specialization produces greater economies of scale), and domestic multiplier effects that can be expected from any income-enhancing activities or policies.

Import prices are likely to decline about $18 billion, increasing real incomes. Greater specialization and economies of scale will boost GDP about $10 billion, reflecting a 0.1 percent increase in average productivity across all industries (or about .3 percent in trade-related industries), plus a small gain from shifting to high-productivity industries. This productivity increase should produce some combination of lower domestic prices, higher profits, and higher wages, all of which should stimulate domestic demand. Moreover, increased spending will create additional income gains, which will trigger even more spending. These multiplier effects will be about one half of the initial income gains. These factors combine to produce incremental GDP of about $42 billion in each region.

These estimates assume that the increase in European exports to the United States (and the increase in U.S. exports to Europe) will come primarily at the expense of domestic production, not third-country exports. In other words, trade-creation effects should exceed trade-

diversion effects. Both general free-trade-area theory and the Canada-U.S. FTA experience support this assumption. In theory, trade diversion is minimized when the affected economies are large and their pre-FTA tariff levels are low - a perfect description of current conditions in the United States and Europe. Further, the trade flows resulting from the U.S.-Canada FTA did not produce significant trade diversion. In fact, third countries have actually benefited from trade creation in the U.S. market since 1989. Although greater trade diversion would increase U.S. and EU GDP by improving the balance of trade in each region (at the expense of other countries), the gains resulting from lower import prices and enhanced efficiency would be reduced.

The Canadian Experience

The macroeconomic impact of a TAFTA can also be gauged by examining the effects produced so far by a comparable free trade agreement, that negotiated between the United States and Canada in 1987. Although the Canadian and EU economies are of course very different in certain respects, in others they are close enough to enable this example to serve as a useful cross-check.

Both are advanced, industrialized entities. Both engage in enormous trade and investment with the United States. Despite the Canadian economy's relatively small size, Canada is America's leading individual-country trade partner. Both feature truly democratic governments. Both boast highly developed, largely transparent, rules-based legal systems. And both economies feature prominent private sectors with substantial independence from the state. The FTA between Canada and the United States has increased trade between the two countries by about 30 percent over levels it would have reached in the absence of such an agreement. A comparable increase of 30 percent in current U.S.-EU trade levels would mean roughly an extra $50 billion in exports from each region, or $100 billion total new trade.

Other Potential Gains

The macroeconomic impact of a TAFTA would not be confined to changes in the U.S. and EU economies. An FTA between the world's two largest economic entities would undoubtedly produce major ripples around the world. In particular, it could be expected to generate significant market-opening pressures on third regions, such as East Asia.

Japan does not import at anywhere near the levels of other industrialized countries. Most of its anomalous trade behavior is explained by its trade barriers. Other major East Asian countries substantially under-import as well.

If Japan's imports rose to normal industrialized-country levels, U.S. exports to Japan would rise by some $50 billion and America's GDP would gain $100 billion. If Asia's other major trading powers took similar liberalization steps, U.S. exports to these markets would increase by as much as $30 billion, and output would jump by $60 billion. These GDP increases result directly from the effect of higher exports to these other regions, which would reduce existing trade imbalances and their domestic multiplier effects. Secondary effects, such as those resulting from increased specialization and greater economies of scale, are also likely, and would make the gains from trade liberalization even greater.

The EU would also benefit significantly from trade liberalization in Asia. However, Europe's trade gains would be smaller because its penetration of the Japanese market is less than America's.

A Sectoral Reality Check

In order to subject estimated macroeconomic benefits of a TAFTA to greater scrutiny, it is useful to compare them to the potential gains that could be expected for a highly competitive U.S. industry, such as the telecommunications industry, after the elimination of specific European trade

barriers that currently constrain U.S. sales to the European Union. The EU telecommunications market is large and growing. But U.S. telecommunications providers have won only a tiny fraction of the EU market, despite the fact that U.S. firms, when measured by revenue per employee boast major competitive advantages over their international rivals, including European firms. Capturing even ten percent of this vast market would produce sizable gains for U.S. companies. Capturing market share levels reflecting underlying relative competitiveness would yield even more impressive results.

Similarly, if "Buy American" government procurement laws at the U.S. state, federal, and local levels were eliminated, and procurement markets opened, European producers with limited access to procurement in the United States could expect big export gains.

The following table summarizes the range of macroeconomic effects that would result from eliminating tariffs and NTBs in Europe and the United States, plus the effects on their economic fortunes of market opening in third regions.

TAFTA'S MACRO-ECONOMIC IMPACT: SUMMARY OF ALTERNATIVE CASES

	GDP Increase (billions of dollars)		Share of GDP (percent)	
	U.S.	EU	U.S.	EU
Conservative Case	42	42	0.5	0.4
U.S. Canada Free Trade Experience	63	63	0.7	0.6
Conservative Case Plus Market Opening	142-218	94-163	1.6-2.5	1.0-1.7
U.S.-Canada FTA Case Plus Market Opening	163-239	115-184	1.9-2.8	1.2-1.9

TAFTA: A Global Political and Economic Plus

The benefits likely from TAFTA go far beyond economic gains for the U.S. and EU economies. TAFTA would provide a valuable boost for the overall transatlantic relationship. Moreover, contrary to critics' concerns, TAFTA could provide a powerful boost to further

worldwide economic integration--and ensure in the process that integration serves U.S. and Western interests.

Recent transatlantic economic relations have been a major success story for both parties. But future success and harmony cannot be taken for granted. In fact, if present trends continue, economic ties and the overall relationship could be heading into a rocky period.

U.S. and EU economic interests, for example, collided during much of the Uruguay Round of world trade negotiations and clashes have continued in agriculture and many key industrial sectors. Further, the disappearance of a common Soviet enemy has weakened the security ties that contained economic disputes during the Cold War. Despite a common foe, the NATO alliance was racked by repeated military and diplomatic disagreements during the Cold War. Yet the United States and its European allies were able to successfully manage and contain their differences largely because they could draw on decades of experience working together day in and day out on a wide range of issues and subjects from grand strategy to nuts and bolts logistical questions.

No such web of institutions and stock of experience exists for transatlantic economic relations today. If they are not developed, the United States and the European Union could drift dangerously far apart in this new international era. Such drift would be especially tragic today given the economic interests and challenges the two partners continue to share: increased competition from low-wage countries, difficulty exporting to closed Asian markets, the cost of pollution and environmental degradation, and the financing of extensive welfare states for rapidly aging populations.

At the same time, a TAFTA could bring major benefits for the world outside the United States and Europe. Despite significantly advancing multilateral trade liberalization, the Uruguay Round sidestepped or ignored many of the issues that increasingly underlie many of the world's most contentious trade disputes - competition policy, industrial policies, and other frictions arising

from the differences among the various models of capitalism. Indeed, the WTO presently is incapable of dealing with these problems, which result from the accelerating "deep integration" of these still largely asymmetrical economic systems.

A TAFTA, negotiated between two regions already sharing many economic values and practices, would show the rest of the world how to address these problems constructively and efficiently. The overwhelming size of a common transatlantic economic area and the overwhelming incentives it would create for others to conform to its standards could ensure that deep integration is shaped predominantly by liberal economic values.

Without greatly intensified cooperative transatlantic economic efforts to influence the integration process, the market-oriented economies of the West could be fatally divided during the various negotiations that will write the rules for the new global economy. Moreover, if market-oriented values do not predominate in this new economy, political support in Western Europe and North America for continued trade liberalization will be endangered.

Shrinking the Atlantic

Europe and the American Economy

Robin Gaster
Clyde Prestowitz

June 1994

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Executive Summary

With Europe now in the grip of a long recession, and Asian markets continuing to boom, it has become fashionable to speak of America's Asia-Pacific future. Although understandable, such commentary has tended to mask the massive and growing economic links between the United States and Europe. This paper outlines those links in terms of trade, investment flows, and technology, and contrasts them with similar links between the United States and Asia.

1. Trade

Asia has finally become the biggest U.S. gross export market. Taken in conjunction with the huge populations and hence potential markets in Asia, exports underpin the claim that Asia represents the future of U.S. foreign economic relations. This argument is overly simplistic:

- *The nature of the trade exchange with Asia is worrying.* The United States tends to exchange raw materials for high tech goods with Asia. This is not the case with Europe.

- *The trade deficit with Asia is less susceptible to normal macro-economic management.* A falling dollar has been accompanied by continued deterioration in the U.S.-Asia trade balance.

- *Trade in some specific sectors.* Despite transatlantic trade rows in telecommunications, aircraft, and computers, Europe remains a prime export market in each industry; the U.S. trade balance with Europe is strongly positive in each.

- **If exports equal jobs, then trade balances reflect jobs won and lost through trade. U.S. trade balances with Asia are disastrous.** Japan and China alone account for more than 70 percent of the U.S. trade deficit. Without the surpluses America runs outside Asia, the global U.S. deficit would be much larger.

2. Foreign direct investment in the United States (FDIUS)

Much U.S. attention during the 1980s was focused on the rapid runup in Japanese investment in the United States. Japan has now become the second largest investor in the United States, after Britain. Once again, though, perception distorts reality:

- *Europe is still the biggest investor in the United States.* Europe accounts for about 59 percent of overall FDIUS; Asian firms (including Japan) account for around 26 percent. In manufacturing, the figures are 71 percent and 14 percent respectively;

- *Taxes.* European firms in 1990 accounted for $7 billion in U.S. corporate income taxes, as against only $100 million from Asian firms. That differential is 70:1, while the investment ratio is only 6:1;

- *Trade.* European firms operating in the United States account for about 22 percent of the substantial trade deficit run up by foreign affiliates; Japan alone accounts for about 60 percent;

- *Trends in investment.* The trend now strongly favors Europe. Japanese investment in the United States is slowing drastically, and is unlikely to resume previous inflows. European investment is on the contrary likely to increase.

Centuries of investment in the United States by Europeans has created a massive capital stock, which Asian investors will take decades to match, even in the unlikely event that they maintain recent rates of investment. Europe will remain the primary investor in the United States for the foreseeable future.

3. U.S. direct investment abroad (USDIA)

USDIA allows U.S. firms to penetrate otherwise closed markets, gets them closer to customers, provide big flows of cash and profits (which have saved large U.S. firms like Ford and GM), and opens access to foreign technology. Yet U.S. firms have highly unequal investment opportunities abroad:

- *Europe dominates USDIA.* Europe accounts for 49 percent of overall USDIA, while Asia accounts for 16 percent; in manufacturing, those figures are 59 percent and 17 percent respectively;

- ***Japan is still closed.*** From a tiny base, USDIA in Japan has now reached $26 billion -- about 5 percent of total USDIA. But USDIA in Europe is growing equally fast.

- ***Revenues.*** U.S. affiliates in Europe generate revenues of around $800 billion annually, equivalent to 12 percent of U.S. GDP;

- ***Trade.*** U.S. affiliates in Europe maintain a positive trade balance with the United States of $20 billion; those operating in Asia have a trade deficit of $6 billion;

- ***Majority-owned affiliates.*** Only 6 percent of MOFA assets are held in Japan, compared to 60 percent in Europe. Europe provides $40 billion in net income from MOFAs, one-third more than the rest of the world put together.

USDIA is now shifting toward Asia. Despite the European recession, however, U.S. investment in Europe between 1989 and 1992 grew by more than $54 billion -- more than twice as much as U.S. direct investment in Asia. It will probably be many more years before the levels of related revenues and net incomes are equal.

4. Technology

Technology flows have two main components: foreign access to U.S. technology, and U.S. access to foreign technology. In both areas, the relationship across the Atlantic seems quite different from that across the Pacific:

- ***R&D investments in the United States.*** European firms invest about $7 billion in R&D in the United States each year; Asian firms invest only $0.5 billion;

- ***Technology imports.*** European firms import vastly more technology into the United States from their parent companies than do Asian companies, even per dollar of invested capital. This disparity is reflected in royalty payments.

- ***Targeting.*** Asian firms specialize in buying up small U.S. firms in critical component sectors. They accounted for more than 60 percent of such purchases from 1988-1993, as against less than 25 percent for Europe.

- ***Access to technology programs.*** Europe has widely included U.S. firms into its technology programs, with U.S. participants now numbering in the hundreds. Access to Asian technology programs is much less widely available.

- ***Strategic alliances.*** Recent data suggests that in six core manufacturing sectors, U.S.-European alliances account for 46 percent of all alliances, as against less than 33 percent for U.S.-Japanese alliances. This ratio has shifted only slowly since 1985.

5. Conclusions

In each of the four dimensions, the link between Europe and the United States is central to U.S. economic relationships. In most areas, relations with Europe are much more important quantitatively than are similar U.S. relations with Asia. The evidence strongly suggests that this will remain true well into the next century.

Moreover, it is the Europeans who share most strongly U.S. views about the future of the world economic order. Although there are clear differences between American capitalism and European capitalism, they are dwarfed in comparison with the gulf existing across the Pacific. On a number of economic issues central to the next decade and the next century -- trade law, competition policy, labor law -- U.S. interests and those of the Europeans are tightly aligned.

From this analysis flow some important policy prescriptions. First, it is crucial not to mistake policy differences for conflicts over principle. The United States fundamentally agrees with the Europeans on most major issues concerning the organization of the international economic order.

Second, if the United States is to influence significantly the rapidly emerging new global economy, it will need allies. Many of these allies are to be found within Europe.

Third, the Europeans take U.S. works and U.S. actions seriously. Words said at conferences in Seattle and Seoul are read carefully in Bonn and Barcelona. It is unwise to push Europe into considering a future without close links to the U.S. In particular, the notion of the United States playing an Asian card against Europe should be buried.

Finally, both Europe and the United States need to consider new ways to support and manage joint interests. Currently, there are serious policy dislocations across the Atlantic and insufficient mechanisms for integrating the needs of the public and private sectors. New channels of communication inside and especially outside government are clearly needed.

Two specific sets of steps should be taken.

First, North America and Europe should open exploratory discussions aimed at broadening and deepening economic relations among those countries fully committed to market-based economic systems. Although talks would begin around a North American-European core (possibly building on current, low-level U.S.-European Union discussions of regulatory harmonization) their scope would not be limited by geography. Non-Atlantic countries that would be excellent early candidates for inclusion would be Chile and Singapore. Moreover, participation -- and the benefits of freer trade, investment, and technology flows -- would be open to countries willing to conform with the group's core principles and practices.

These discussions would encourage the world's most market-oriented countries to resolve their remaining differences not only on international economic policy but on those domestic issues that bear heavily on international commerce, such as labor policy, competition policy, and environmental and other forms of non-economic regulation. It would also offer an opportunity to develop more strategic and longer-term views of the world economy, while allowing these countries to work more closely together to address the many difficult domestic problems that have emerged in a world of rapidly accelerating economic, technological, and social change.

Such discussions should not be seen as a challenge or threat either to the new World Trade Organization or to any less market-oriented economy. The former should simply be seen as a platform from which like-minded countries can go further in integrating their economies on terms that they find mutually acceptable; the latter would simply find further encouragement to move in directions that both the United States and European Union would applaud.

These discussions would, in short, start the United States and Europe down the path toward an economic parallel to NATO. The latter has provided a forum for the development of joint policies with specific aims and objectives. As US and European concerns shift from military security to economic security, it is equally important to develop a similar forum for economic issues, both international and domestic. It is the continuing absence of such a forum which has placed the spotlight squarely on US-EU quarrels in recent years, rather than on shared practices and mutual interests and objectives.

Second, as this effort proceeds, business leaders on both sides of the Atlantic should set up a forum through which they can communicate their views to their governments. Businesses around the Pacific Basin have benefited from the creation of the Pacific Basin Economic Council, which serves as a private-sector voice and promotes business interests and expanded trade and commerce among North America, Pacific Latin America, East and Southeast Asia, and Australasia. Businesses in North America and Europe could secure the same benefits by creating an Atlantic Basin Economic Council.

Introduction

Former American ambassador to Tokyo Mike Mansfield was fond of calling the U.S.-Japan relationship the most important bilateral relationship in the world. Yet for all the undeniable importance of the interaction of the world's two largest national economies, this statement is an exaggeration. The U.S.-Japan relationship continues to be outweighed by America's ties with the European Union (EU). And the U.S.-European relationship remains Number One not only in the security sphere, but in the economic sphere as well.

Nonetheless, transatlantic relations stand at a critical juncture, and much evidence indicates that their continuing importance is not fully appreciated in the United States. Some of the reasons are understandable. The Asia-Pacific region's sheer size, its breathtaking economic and technological progress, and its staggering potential -- both as market and as rival -- make it easy to overlook a European Union whose unemployment rates are too high, whose growth rates are too low (when they are positive at all), and whose once promising integration plans seem to have stalled out.

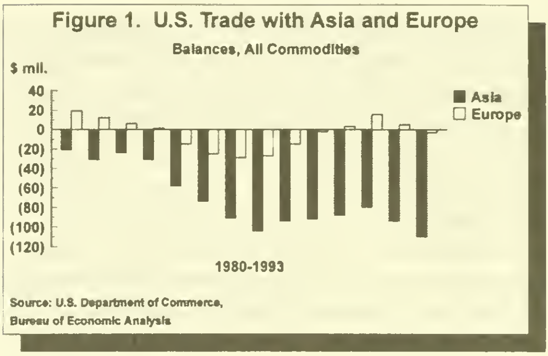
But not only does the European Union -- which will soon expand its membership, at least -- still represent America's biggest and most profitable economic partner. Washington's frustration with alleged European foot dragging at the recently concluded world trade talks and the resulting talk of an American tilt toward Asia overlook the fact that, in the realm of economics, what unites America and the European Union is more important than what has been driving them apart. As highly developed industrialized regions with fully democratic governments and relatively generous welfare states, the United States and the EU share common values and common problems. Some of the latter involve the economic challenges posed by the distinctive, closely related systems of capitalism that have sprung up all around the Pacific Rim. Although these systems all use mechanisms, they

differ qualitatively from their U.S. and European counterparts in areas such as business structures and openness to foreign commerce. Other shared problems include coping with technology-generated unemployment, finding affordable ways of providing health care for aging populations, preserving the environment, and preventing the welfare state from smothering economic incentives. The United States and the European Union may not be able to -- and may not want to -- forge a common approach to deal with these challenges. But because the two parties seem to have forgotten many of their common interests (or maybe because they take them for granted), they risk missing an opportunity to explore promising new modes of cooperation.

The United States and Europe must do nothing less than adjust to sweeping global change. Their modern relationships are products of the Age of Aggressive Totalitarianism. From 1941 to 1991, America and European democracies were drawn together by the need to resist first fascism and then communism. Security considerations dominated policy making -- at least in Washington. As has been widely noted, the collapse of Soviet totalitarianism has called this policy framework into question. Economic relationships, which have been more complicated and so far more divisive, are attracting growing attention. Currently, transatlantic economic relations are being driven by a series of quarrels over trade policy issues, such as steel, telecommunications, various agricultural commodities, semiconductors, public procurement policies, the new World Trade Organization (WTO), and dealing with Japan. These disputes and others like them should not obscure the two regions' numerous common ties and interests nor prevent their cooperation to achieve a new world economic structure compatible with their shared values.

This study attempts to shed light on the true nature of U.S.-European and U.S.-Asian economic linkages, and to draw policy conclusions.

These linkages are defined in terms of four economic dimensions:



trade, inward investment, outward investment, and technology flows. This study assesses both the current status and likely trends in these areas.

This detailed analysis shows that Europe remains by far the most important economic partner for the United States. This does not mean that recent efforts to develop an appropriate U.S. policy for Asia, or for China, or for Japan, should be halted or even slowed. It is obvious after all that Asia is a booming part of the world economy, and that no sensible U.S. policy can ignore or slight it.

But this conclusion does indicate that America's stake in a close and friendly ***economic*** relationship with Europe should not be an afterthought of U.S. policy. Instead it needs to be a central plank.

This is in itself an important conclusion. Yet its significance is much enhanced by two other sets of challenges now facing the United States, both of which underscore the importance of close and friendly links with Europe.

First, the period of U.S. global economic predominance is over. Yet the need for U.S. influence over that economy has never been greater, as growing trade and investment flows have an increasing impact on the U.S. economy. Obviously, the United States will need steady, reliable, and powerful allies as

it seeks to ensure that the new world economic order corresponds to both its ideological and its practical objectives. As the basics of a world economy predicated on free trade are put into place, issues for which a partnership with Europe makes sense will come increasingly to the fore. These include competition policy, labor rights, consumer protection, the environment, intellectual property rights, and many other fields. In each case, global policies are needed, and global policies are possible only if powerful global actors can collectively agree on them.

Second, the United States faces tremendous domestic challenges, as it adjusts to a world of intensified competition, especially for low-skill jobs. These challenges are in many respects identical to those which have emerged in Europe. Europe has apparently chosen to respond to this challenge with higher wages and high unemployment -- hardly an ideal solution. But the U.S. policy of lower wages and lower unemployment is certainly no permanent solution to the problem of structural transformation, either. Both Europe and the United States stand to benefit by pooling resources and sharing experiences in cooperative efforts to face these challenges.

Hence regardless of the deepening relations between the United States and Asia, both Europe and the United States must make much greater efforts to shrink the Atlantic. Given the needs of both sides, it would be truly perverse to allow quarrels over day-to-day issues to poison the well of shared objectives and shared ideologies; it would be even worse to do so on the basis of a faulty understanding of the real economic issues at stake.

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I. Trade

The argument for tilting U.S. policy toward Asia is largely based on the region's huge potential markets. They are indeed huge -- potentially. Thus, a more Asia-oriented economic policy thus appears as the natural culmination of an apparently inevitable reordering of global economic clout.

Even in terms of trade relations, though, this argument misses more than it covers. Its proponents tend in many cases to equate gross exports with net benefits to the U.S. economy. As a result, they badly undervalue the qualitative and quantitative importance of trade with Europe for the U.S. economy.

This section begins with a review of broad trade patterns, and considers how they have changed in response to shifts in exchange rates (the primary macroeconomic balancing tool). It then discusses trade in manufactures and primary goods, and proceeds to examine the manufacturing sector in more detail, focusing on telecommunications, civilian aircraft, and office equipment. These three sectors were selected because each has generated highly public conflicts between the United States and Europe. At each level, comparisons will be drawn with Asia and in some cases with Japan in particular. Once again, though, it is important to remember that the purpose of the comparison is to illuminate the contribution of Europe, not to denigrate U.S. ties to Asia.

U.S. trade with Europe[1] and Asia[2]

The broadest levels of analysis show that Asia is America's largest export market (Figure 2).

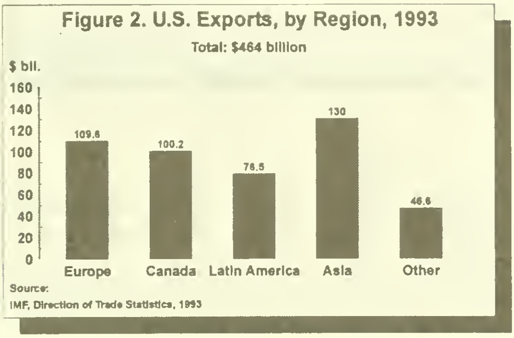

Figure 2. U.S. Exports, by Region, 1993

Yet a review of trade balances, rather than simply exports, tells a rather different, and much more disturbing, regional story (Figure 3):

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[1] For the purposes of this study, and unless otherwise noted, Europe is defined as the 12 members of the European Union, plus Norway, Sweden, Austria, Switzerland, Finland, and Iceland.

[2] Asia does not include the Asian parts of the former Soviet Union.

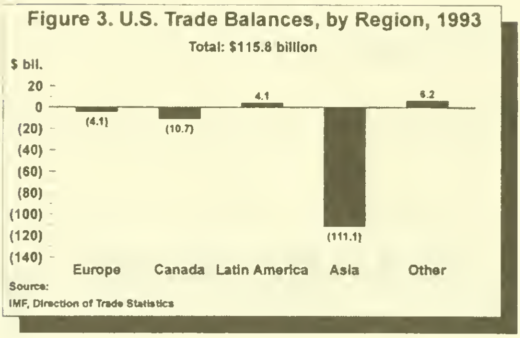

Figure 3. U.S. Trade Balances, by Region, 1993

Thus although Asia has indeed finally overtaken Europe to become the largest export market for the United States, this has done nothing to staunch the huge hemorrhage of U.S. dollars flowing east. Given the equation frequently made between trade and domestic jobs, this fact clearly indicates the balanced impact of Europe on the U.S. jobs market.

Regional balances and exchange rates

The sheer sums involved are staggering. Since 1980, the United States has accumulated fully $1.25 trillion in trade deficits. Of that deficit, Asia has accounted for $882 billion, while the EU accounts for only $10 billion. In 1992, the trade deficit with Asia ($103.8 billion) accounted for 98 percent of the total U.S. deficit. These huge imbalances emerged during the mid-1980s, and have not shifted much since then, as Figure 3 indicates.

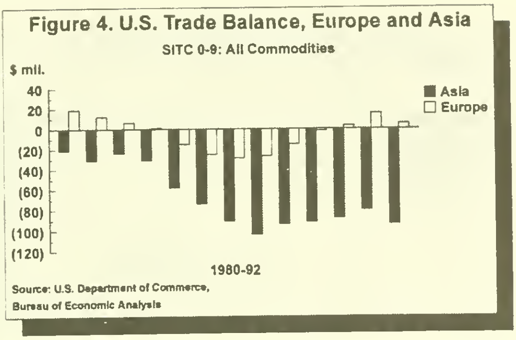

Figure 4. U.S. Trade Balance, Europe and Asia

The big Asian deficits have not responded as expected to the application of the one macroeconomic tool specifically designed to deal with them: changes in the exchange rate. The U.S. dollar has fallen on a trade-weighted basis from an indexed level of 170 in 1985 to 100 in 1992;[3] during that period, America's deficit with Japan actually increased in nominal dollar terms, even though the dollar has fallen from ¥220 to around ¥101 (see Figure 4). The primary effect seems to have been to cut the cost of U.S. assets by half, in yen terms.

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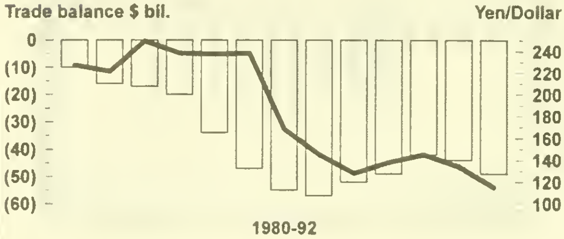
[3]IMF, *Direction of Trade Statistics Yearbook*, 1993

Figure 5. Yen/Dollar Exchange Rate and U.S. Merchandise Trade Balance with Japan



Source: U.S. Department of Commerce, Bureau of Economic Analysis; IMF

The story for Asia as a whole is rather more complex; some of the Asian currencies are tied directly to the dollar, while some other economies have adjusted by shifting U.S. - bound production to other Asian countries, notably China. The use of other economies as trans-shipment points ensures that exchange-rate shifts can have only a minor impact. What is clear, however, is that the trade-weighted decline of the dollar does not seem to have had much effect in shrinking the U.S. deficit with Asia.

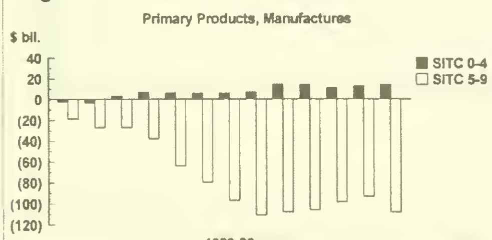
The picture for Europe is very different, and shows substantial effects from exchange-rate shifts. Beginning in 1985, the U.S. dollar fell substantially and, after the expected lags, the EU's merchandise trade balance shifted accordingly.

The composition of trade

Deficits matter. But the composition of the deficit is also important. It matters whether the United States is a nation of extractors and commodity suppliers, or one manufacturing high value products and providing high value services.

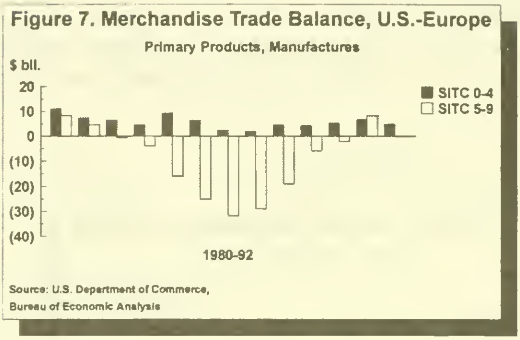
At the broadest level, a distinction can be drawn between industries that are primary or extractive, and those containing high-value manufacturing and services. Very crudely, these two groups of industries tend to correspond to groups 0-4, and 5-9, respectively in the U.S. Commerce Department's Standard Industrial Trade Code classification system.[4] Figure 6 compares U.S. trade balances with Asia and with Europe for these two industry groupings:

Figure 6. Merchandise Trade Balance, U.S.-Asia



Source: U.S. Department of Commerce, Bureau of Economic Analysis

[4]SITC 0-4 includes: food and live animals; beverages and tobacco; crude materials, inedible, not including food; mineral fuels, lubricants, etc. SITC 5-9 includes: chemicals; manufactured goods by chief material; machinery and transport equipment; miscellaneous manufactured articles; commodities and other transactions.



Figures 6 and 7 show that, for primary products, the United States typically maintains a small surplus with both Asia and Europe. For the latter, the U.S. balance in manufactured goods responded quite rapidly to changes in the exchange rate in the late 1980s, shifting from substantial deficit to a small surplus by 1990. For Asia, though, the balance in manufactures has not responded at all to declining U.S. exchange rates. The balance went heavily negative in the early 1980s, and has remained heavily negative since then.[5]

This is the factual basis for arguing that the United States has become a classic third world economy in relation to Asia in general and Japan in particular: the United States has a positive trade balance in raw materials, but maintains a massive and continuing deficit in manufactured goods. That is not a propitious basis on which to build a 21st century economy in America.

[5]Simply looking at SITC 0-4 and 5-9 is of course a simplification; specifically, the case for Japan as an outlier becomes stronger if SITC codes 5,6,7, and 8 are disaggregated. Conversely, the case can be made that the rest of Asia is a better trade partner than it appears from the more aggregated data. Yet neither refutes the argument that the balances with Europe are quite different from those with Asia, and better from the U.S. standpoint as well.

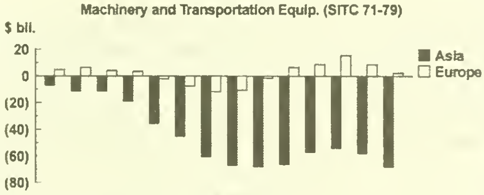
The heart of the matter: core manufacturing industries

The heart of an advanced manufacturing economy is found in SITC codes 71-79, which include telecommunications, computers, autos, aircraft, machine tools, and power generating equipment.[6] Chair of the President's Council of Economic Advisors Laura D. Tyson and others have shown that there are substantial spillover effects from these industries across the economy in terms of high value-added production and hence high-wage manufacturing jobs.

In eight of the nine SITC 71-79 industrial sectors, the United States has a vastly better trade balance with the EU than it does with Asia. U.S. merchandise trade balances with Europe and Asia for SITC Codes 71-79 are displayed in Figure 8 below:

Fig. 8. U.S. Merchandise Trade Balance Europe and Asia

Machinery and Transportation Equip. (SITC 71-79)



Source: U.S. Department of Commerce, Bureau of Economic Analysis

[6]SITC 71-79 include: Metalworking machinery, power generating equipment, general industrial machinery, office machines and computers, telecommunications equipment, electrical machinery, road vehicles, and other transportation equipment (including aircraft and parts).

Figure 8 indicates that although the fall of the dollar after 1985 did have some effect on U. S. trade in manufactures with both Europe and Asia, that effect was sufficient to entirely reverse the deficit only with Europe. For Asia, the impact was both rather small (reducing the deficit by about 15 percent from 1991 to 1992) and temporary (the deficit returned to its previous peak by 1993, despite the growth in the U.S. economy after early 1992).

Within the "manufacturing core" itself, it is worth looking in particular at three industries. These are cases where the story caught by the headlines and the reality portrayed by the data are quite different. They spotlight the reality that underlies apparent problems in the U.S.-EU trade relationship.

Three key sectors: telecommunications, electronics, civilian aircraft

From the newspaper headlines and talk shows, one would gather that U.S. firms have been shut out of EU markets in all three of these crucial sectors.

Recent transatlantic fights over telecommunications have focused on public sector procurement. Ironically, the real successes achieved in starting the liberalization of European procurement rules have been overtaken by debates about whether AT&T was actually a public utility -- and hence subject to agreed public procurement rules -- or a private company, facing market disciplines. Also prominent has been the issue of how quickly EU telecommunications markets would be opened.

The most serious conflicts over electronics have involved tariffs, with the Europeans doggedly sticking to 14 percent tariffs for semiconductors (to be cut in half by 1988, under the recent GATT agreement). Other conflicts have focused on rules of origin and European public procurement rules, as well as arguments over European anti-dumping and anti-circumvention regulations. New U.S. technology policy initiatives in this sector now seem likely to restart a U.S.-EU argument about foreign access to such programs on both sides of the Atlantic (the argument over "conditional national treatment").

Finally there has been the long-running row over Airbus, which has received by most accounts approximately $13-17 billion in "launch aid" from European governments.[7] How this -- or U.S. government support for the commercial aerospace industry via military procurement programs, or, for that matter, analogous European military subsidies for the aerospace sector -- affects the current cost of commercial airliners remains a controversial question.

The data underlying each of these arguments are in dispute, and the arguments themselves have been very high profile. Yet the fact is that, taken together, Europe has been the best customer in the world for U.S. exports in these sectors over the past five years. The United States also consistently runs large trade surpluses with the EU in each sector, and the trends continue to move in directions favorable to the United States.

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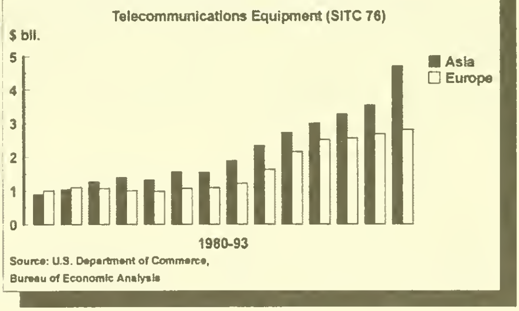
[7]See Office of Technology Assessment, *Competing Economies*, Appendix B, Washington, D.C. 1991 for a full discussion of this contentious issue. Other estimates are rather higher.

Telecommunications equipment[8]

Currently, news and business journals are filled with stories about the telecommunications opportunities in Asia. AT&T has recently broken through into the China market, and some industry observers anticipate sales in the hundreds of millions of dollars by the year 2000.[9] The Asian boom is already being reflected in U.S. export figures, as Figure 9 below shows very clearly. After several years in which U.S. exports to Europe actually grew faster than exports to Asia (1988-90), the recession in Europe and boom in Asia have suddenly reversed this trend. Today, even though the United States sends around $2.8 billion annually of these goods to Europe, the U.S. exports almost two-thirds as much again to Asia. Nonetheless current U.S. exports to Europe in this sector are still more than twice the level of exports to Japan (less than $1.2 billion.).

Figure 9. U.S. Exports to Europe and Asia

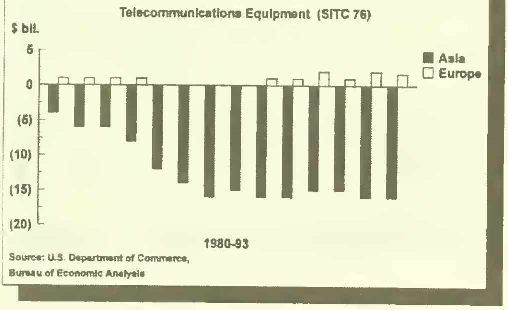


[8]The definition of "telecommunications equipment" is difficult, and different authorities use different definitions. SITC data seems likely provide sufficient clarity and coherence for purposes of regional comparison.

[9]"Major U.S. Companies Push for Renewal of MFN with China," *Global Telecom Report* 4, No. 10, May 16, 1994.

Yet Asia's advantage as an export market in telecommunications is not reflected in trade balances. U.S. imports from Asia vastly outpace those from Europe (especially since major European equipment suppliers such as Siemens have a manufacturing presence in the United States). As a result, the United States faces continuing and expanding trade deficits in telecommunications equipment with Asia, while maintaining a modestly positive trade balance with Europe.

Fig. 10. U.S. Trade Balance, Asia and Europe

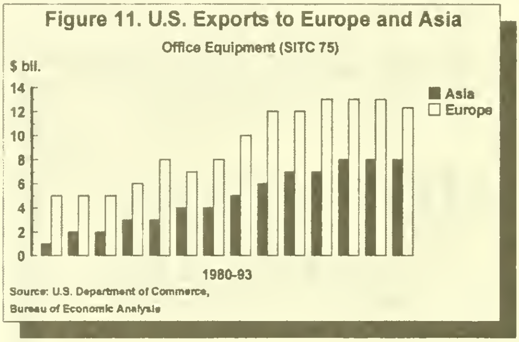


In fact, Figure 9 shows that the U.S. trade deficit with Asia in this sector is more than 3 times the total level of U.S. exports to Asia.

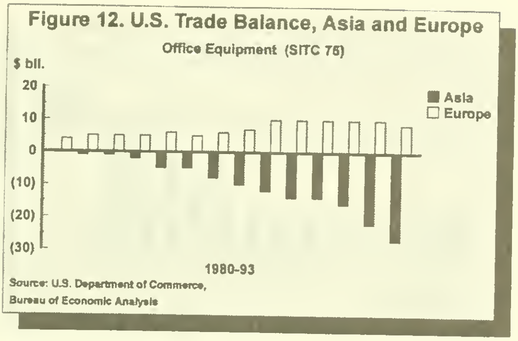
Computers and office equipment

Talk to any big office equipment manufacturer in the United States, and they will probably tell you that sales to Europe, and profits from Europe, are crucial for their companies.

U.S. exports of office equipment (including computers) to Asia have grown rapidly in recent years, and have now reached $8 billion. Yet they still do not approach exports in this sector to the EU, which are running at more than $12 billion. Moreover, until the recession began in Europe, exports to Asia were growing no faster than exports to Europe. And despite the Asian boom, U.S. exports to the region have been flat since 1990, which may indicate a structural change in this sector -- perhaps the outsourcing of more production to the Far East (see Figure 10).



Partly because export growth has slowed, the U.S. office equipment trade deficit with Asia has widened rapidly during the past ten years, and has now reached $27 billion -- again, 3 times the level of U.S. exports. In contrast, the U.S. sectoral trade surplus with Europe is almost $9 billion, despite Europe's deep recession, trade barriers, and restrictive government policies (see Fig. 11, below).

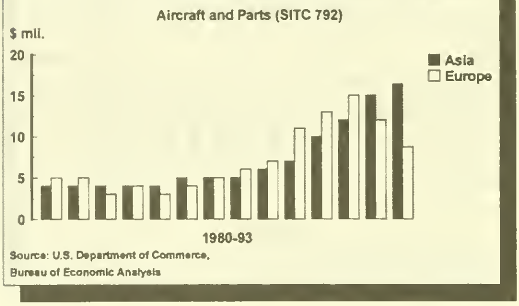


Civilian aircraft

This final case is especially significant. The U.S.-EU row over Airbus is among the most serious in the long history of U.S.-EU trade conflicts. It is -- especially in the press -- sometimes taken to indicate that European markets are largely closed, and that Boeing and McDonnell Douglas have only severely limited opportunities there. The latter may be the case, but the former is not.

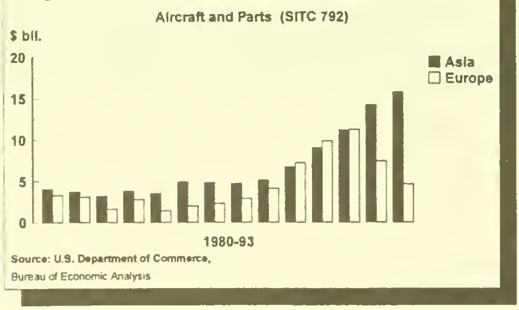
Only with the recent deep recession in Europe have U.S. civilian aircraft exports to Asia overtaken exports to Europe. As late as 1990, exports to Europe maintained a comfortable lead of more than $2 billion in sales annually. The recession and other factors have led to a collapse in the European market just when new opportunities have been emerging quite rapidly in Asia. As a result, the United States now exports almost twice as much in this sector, by value, to Asia as it does to Europe.

Figure 13. U.S. Exports to Europe and Asia



Whether this sudden divergence presages a fundamental shift in purchasing patterns is unclear. It is almost certainly true that the European aircraft industry faces a period of prolonged shakeout, which could reduce demand overall, while Asian growth may produce accelerating demand. European liberalization, however, is just as likely to open opportunities for U.S. firms, while Asian growth could lead to the development of indigenous aircraft industries in the region.

Figure 14. U.S. Trade Balance, Asia and Europe



Once again, the trade balance reveals much more than trade volumes. Although the recession has reduced U.S. aerospace exports to Europe, and although the European countries plainly have targeted civilian aircraft as a strategic industry, America still enjoys a trade surplus of more than $5 billion with the EU in this sector.

The point in this case is rather simple, and one similar to those in the other sectors under discussion: despite the recent downturn, Europe still constitutes an extremely important export market for the United States in each of these sectors.

Trends in trade

Although existing trade patterns are important, trade trends are at the heart of arguments for prioritizing U.S. linkages to Asia. Proponents claim that whatever the current trade balance, the huge potential of Asian markets means that the United States must focus on "the most dynamic economic region in the world." This view is reflected in several recent documents from the Export Administration at the Department of Commerce.[10]

Just how dramatic are these trends, even taken at face value? They start from current circumstances -- the fact that Asia has become the biggest purchaser of U.S. exports, accounting for 27.2 percent of all purchases in 1992, compared with 26.3 percent for Europe (see Figure 2). In the core of the manufacturing sector, SITC 71-79, U.S. exports to Asia reached $70 billion in 1993, compared with $50 billion to Europe. To this is added the recent growth rates in many Asian economies (especially China), projected some decades into the future. This data is then leveraged against demographic data, which indicates the massive size of potential Asian markets, and their likely continued growth due to expanding populations. The conclusion is that U.S. exports to Asia are likely to grow explosively during the coming decades.

[10]See, for example, , *The Big Emerging Markets: Changing American Interests in the Global Economy,* Under Secretary for International Trade Jeffrey Garten, (Washington, D.C.: U.S. Department of Commerce), Jan. 20, 1994.

How good are these arguments?

To begin with, past and present are not always prologue; current trends often come to an end (as every roulette player knows). Each trend needs to be placed in context, a task far beyond the scope of this paper. Yet the process of describing the context can at least be begun.

In the case of Asia, some of the trends are almost certainly topping out (economic growth in Japan, for example, is unlikely to regain the 5-7 percent level of the 1960s and 1970s). Similarly, assumptions about huge Asian consumer markets require careful scrutiny.[11]

Simple straight-line extrapolation will not do. On the Asian side, uncertainties include:

- *Slowing growth?* Economic growth is now leveling off for a number of East Asian economies, not just Japan; China may not be able to sustain double digit growth without explosive inflation or severe internal dislocations;

- *The role of China.* China remains a huge question-mark for political reasons as well, and because it has a strong historical attachment to self-sufficiency;

- *Tough markets to crack.* In many industries, U.S. exporters have continued to find it hard to crack the biggest Asian markets, notably those in Japan. Recent policy efforts notwithstanding, there is no sign that U.S. exports to Japan are about to take off;

[11]U.S. business has gone through successive cycles of unrequited excitement about the Asian market about every 25 years since Commodore Perry reached Japan in 1853. Today's Asia enthusiasts should remember the "800 million pairs of (Chinese) feet to be shod!", marketing copy from the 1920s.

- ***A regional bloc?*** Intra-regional trade in Asia is growing much faster than trade outside the region, forging links that may tend to shut out U.S. exporters;

- ***Japanese influence.*** Japanese firms have already staked out large leads in markets and investments in many East and Southeast Asian nations. These markets may be tougher going for U.S. firms in the future.

- ***Limits of export-led growth strategies.*** The export-led growth relied on by the Asian economies will be much harder to maintain in the future, now that all the major powers have turned their full attention to economic competitiveness and jobs;

As a result of these and no doubt many other factors, it would probably be a mistake to extrapolate directly from the substantial growth of the past 20 years into the next 20. Yet even if Asia's growth continues at healthy rates, the widespread tendency to ignore or slight Europe's current and future importance is unwarranted. In fact, a similar look at Europe provides almost a mirror image, even though West European economies are currently stagnant, and anticipate only slow growth in 1994.

U.S. firms have already done reasonably well in Europe. But European governments still protect domestic markets, and these policies have affected industries where U.S. firms are especially competitive, notably autos, electronics, computers, telecommunications, semiconductors, and aerospace.

Now these European barriers are being reduced across the board under the driving impact of the Single Market. Along with the GATT agreement, this development offers substantial prospects for market expansion for U.S. firms, even if European markets remain relatively stagnant -- which they probably will not.

Take two examples. First, the EU telecommunications equipment market is currently around $18 billion annually.[12] U.S. exports supply around 12 percent of that market ($2.25 billion),[13] with further sales coming from U.S. operations in Europe and elsewhere.

If new technologies and planned deregulation expand the equipment market by only 7.5 percent annually -- a conservative estimate -- and if the share open to U.S. firms expands by only 7.5 percent annually over the next five years -- also a conservative estimate -- U.S. exports could quite easily double by 1999, in real terms, to more than $4.5 billion. That growth would alone be more than the total expected U.S. telecommunications equipment market in China, currently the "market opportunity of the decade."

Second, deregulation and privatization are coming to European aerospace markets just as inexorably as they are coming to telecommunications. Once again, this will sharply increase demand for aircraft, even as ticket prices fall. Perhaps more important, deregulation also implies the erosion and eventual destruction of tied links between the Airbus consortium and the various national airlines. Freed of government pressure to buy Airbus, some companies are likely to choose U.S. competitors, as British Airways does already. Hence there is every likelihood that the demand for U.S. aircraft and parts will increase substantially over the next ten years, especially if air traffic expands after deregulation as fast in Europe in the 1990s as it did in the United States in the 1980s.

In short, even though many U.S. industries are already exporting rigorously to Europe, the removal of rigidities and market failures that have in the past reduced European growth and closed out U.S. firms may now offer significant new opportunities. And because Europe controls a substantial part of the world's capital stock, this demand can materialize quite rapidly. In addition, Europe has its own emerging hinterland: Eastern Europe and the

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[12] *Eurobit Information Technology Observatory*, 1993, p. 24.

[13] Definitions of "telecommunications equipment" are highly elastic, and it is likely that the European definition is quite different from the Commerce Department's. The data above use European definitions.

former Soviet Union. These markets are not likely to provide any substantial additional demand for U.S. products over the next few years, but may become more attractive in the medium term.

Finally, of course, Europe has been suffering from the worst sustained recession since World War II. The slump, however, was precipitated largely by the specific problems created by Germany's desire to achieve rapid economic integration with the former East Germany. When European growth resumes, as it seems likely to by the end of 1994 or early 1995, U.S. views on the relative significance of European markets could again become much more positive.

Conclusions: The real story of regional trade patterns

The data presented is this section suggest that the views often headlined in the media are mistaken. It is obvious that Asia is a large and important market for U.S. exports. Yet it is also true that:

- European markets in many key manufacturing sectors are larger; in the industries where conflicts have been most visible between the United States and Europe, U.S. exports have been extremely strong;

- U.S. trade balances with Europe in these sectors are consistently positive; U.S. trade balances with Asia in these core sectors are not only highly negative, they are not improving;

- There is no sign that any of these realities or trends might be substantially reversed in the near future;

- Trade with Europe is susceptible to management through macroeconomic levers, such as exchange rates; trade with Asia is much less so;

- America's trade with Europe in both primary and manufactured goods is balanced; American trade with Asia shows small

surpluses in the first and big deficits in the second, a fact with profound implications for the future development of the U.S. economy;

- Current perceptions of growth patterns almost certainly exaggerate the long-term rate of growth in Asia (however impressive it will surely be), and probably understate growth rates in Europe.

These conclusions should not come as a surprise. U.S. industry has complained for years about access to Asian markets. If conflicts have erupted more visibly with Europe, perhaps it is because the European Commission has been more open to meaningful negotiation and to implementing reforms. Each of the major issues with Europe in the three sectors discussed has in the end generated an acceptable negotiated settlement. As both sides are fond of noting, more than 95 percent of U.S.-EU trade is trouble-free.

II. Foreign Direct Investment in the United States

The massive trade deficits of the last decade required a corresponding influx of foreign investment into the United States at the same time that U.S. firms have continued to invest abroad. As a result, inward foreign investment in America has been growing at unprecedented rates, to unprecedented levels, and at rates much faster than trade. At the same time, U.S. firms have of course also continued to invest abroad.

Much of the inflow has taken the form of portfolio investment (investment in securities, cash deposits, and other relatively liquid assets). There are arguments that this inflow has helped to avert liquidity crunches, although there are also darker claims that it makes the U.S. financial system vulnerable to the actions of foreign creditors.

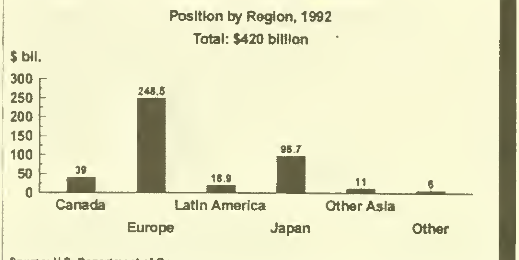
Still, the most visible component of investment into the United States has been foreign direct investment (FDI).[14] Massive inflows from Japan, in particular during the 1980s, moved that country into second place in total direct investment (called "position") by 1992, behind only Great Britain, which after all had a three-century start.

Foreign direct investment now plays a large and growing role in the U.S. economy, now totaling about $420 billion, or 7 percent of GNP (the stock of U.S. investment abroad is now some $485 billion). It has, by and large, had a positive impact on the U.S. economy. Studies from the Institute of

[14] FDI is defined by the Department of Commerce as the ownership of 10 percent of or more of a U.S. corporation. In fact, most investors own much more than that, but 10 percent provides a standard and recognized line of demarcation that reflects influence if not necessarily control.

International Economics[15] and the Office of Technology Assessment[16] indicate that foreign companies bring with them jobs, taxes, and sometimes technology when they set up shop in the United States. Whether they bring as much to the table as similar U.S.-owned corporations is a matter of dispute, but the fact that jobs and wealth are created in the United States cannot be disputed.

Figure 15. Foreign Direct Investment in the U.S.



Source: U.S. Department of Commerce, Survey of Current Business, July, 1993, p.67

In recent years, Japanese FDI into the United States has been very high profile.[17] Big money went into existing manufacturing operations, especially for small high tech companies; an array of big greenfield (newly constructed) plants, especially for auto production; big bets on established media giants (e.g., Sony with Columbia and Matsushita with MCA); and massive amounts of prime real estate (e.g. Rockefeller Center in Manhattan and the Pebble

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[15] Paul Krugman and Edward Graham, *Foreign Direct Investment in the United States* (Washington, D.C.: Institute for International Economics), 1989.

[16] Office of Technology Assessment, *Competing Economies*, (Washington, D.C.: U.S. Government Printing Office), 1991.

[17] Japan is used as the reference point instead of Asia for most of this section partly because Japan accounts for more than 90 percent of Asian investment in the United States, and partly because data on Japanese operations here are much more plentiful than is information on Asian operations in general.

Beach golf course in California). Collectively, these investments constitute perhaps the biggest and most visible international buying spree in history.

Yet even after the investment binge ended in 1991, Asian investment was still dwarfed by the massive position built up by European investors over the years. As Figure 15 shows, Europe still accounts for almost 60 percent of all foreign direct investment in the United States, while Asian investors account for just slightly more than a quarter.[18]

The same story applies to FDI in manufacturing, despite those well-publicized Japanese investments. European affiliates account for 71 percent of total FDI in the manufacturing sector, while Asian firms account for just 14 percent (see Figure 16).

[18]In fact, data from the U.S. Commerce Department's Bureau of Economic Analysis, on which all FDI analysis rests, significantly *understates* European investment relative to Asian investment because BEA data is calculated on an historical cost basis. This approach systematically undervalues older investments relative to newer ones. One recent survey of 3,700 majority-owned foreign investors by KPMG Peat Marwick found that 62 percent of European investment dated back at least to 1985 (and much of it no doubt to much earlier periods), while that was true for only 46 percent of Japanese firms surveyed. (KPMG, *European Investment in the United States, vol. 1.* study prepared for the Commission of the European Communities, March, 1993).

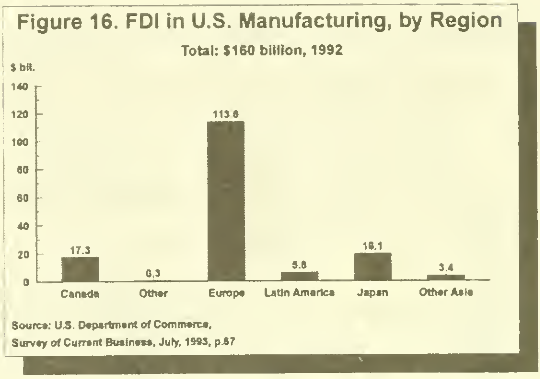

Figure 16. FDI in U.S. Manufacturing, by Region

The link between current account surpluses and direct investment in the United States now appears to be weakening, particularly for firms from Asian countries. Continuing massive U.S. deficits with Asia are not being reflected in continuing inflows of direct investment from the region. Apparently, the scars from financial hits taken by earlier Asian investors continue to take their toll (Japanese investors in particular lost heavily with the fall in the yen value of the dollar and the weakness of many of the investments -- especially, but by no means exclusively, in real estate). As a result, the massive expansion of Asian FDI in the United States seems unlikely to be replicated in the coming decade.

Contributions to the U.S. economy: jobs, trade, and taxes

Foreign investors bring a lot more than just money to the United States. They are a source of jobs in the economy; a focus for trade, both imports and exports; and payers of U.S. taxes. In addition, they mediate technology transfers, an issue discussed in Section IV of this paper.

Jobs

In 1990, European-owned firms employed 2.9 million American workers. This total represented

- 62 percent of all U.S. jobs at foreign-owned companies -- a figure slightly higher than Europe's share of FDI;

- 3 percent of total U.S. employment; and

- Job growth at a rate more than twice the rate of job growth in the U.S. economy as a whole, in both 1989 and 1990.[19]

Surprisingly, even after a decade of strong Asian investment, the impact of Asian investment on jobs continues to be relatively small, especially compared to that flowing from European FDI. The distribution of jobs from FDI by region does not seem to have changed very much during the 1980s, as Europe continues to dominate, as shown in Figure 17:

Figure 17. Employment by Foreign Affiliates In the U.S. - 1991

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[19]*Jobs and Investments of European Firms Operating in the United States* (Washington, D.C.: European American Chamber of Commerce), 1993.

European firms account for 62 percent of jobs produced by foreign affiliates, right in line with their overall share of jobs produced by FDI.

Good Jobs?

Jobs with European-owned firms tend to be good jobs. Exactly half are in manufacturing, compared with less than 20 percent for all jobs in the U.S. economy. They also pay well. On average, European firms' employees made $2,477 monthly in 1990, or 18.8 percent more than the U.S. average of $2,085.[20] Even within manufacturing, European firms are slightly better-paying than average.[21]

Because so much European FDI is concentrated in manufacturing, the direct jobs it creates are accompanied by a much greater number of indirect jobs. In fact, according to the job multipliers calculated by the Economic Policy Institute, every single U.S. manufacturing job creates more than four indirect jobs. For retail trade and personal and business services, the multipliers are lower -- about 0.94 and 1.47, respectively.[22]

It is also worth pointing out that some European firms are strong supporters of worker training. Anecdotal evidence suggests that some at least have brought European levels of support for worker training to their U.S. operations. Siemens, for example, started European-style apprenticeship programs in North Carolina, Florida, and Kentucky in 1993. Similar initiatives are being developed nationwide.[23]

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[20] *Ibid.*, p.13

[21] In fact, European-owned firms alone accounted in 1990 for more than 7 percent of U.S. employment in manufacturing, and for more than 10 percent of manufacturing employment in four states: New Jersey, West Virginia, South Carolina, and Maryland. Source: Ibid. p.23

[22] Dean Baker and Thea Lee, *Employment Multipliers in the U.S. Economy* (Washington, D.C.: Economic Policy Institute), March, 1993, p.7.

[23] Siemens, *Siemens '94: A Review of Siemens Businesses in the U.S.A.*, p.3

Trade

Foreign affiliates operating in the United States account for a substantial part of overall U.S. trade. In 1991, European and Japanese firms each shipped about $41 billion in exports (together amounting to about 18 percent of total U.S. exports) but Japanese firms imported far more than their European counterparts.[24] As Figure 18 shows, European imports were about $60 billion, while those of Japanese firms were around $90 billion. Together, these imports account for just under 30 percent of total U.S. imports.

Collectively, foreign affiliates generated a net merchandise trade deficit of $81 billion -- slightly less than the total U.S. trade deficit. Of this total, $48.5 billion (60 percent) came from the activities of Japanese firms. European firms collectively accounted for $12.1 billion, or 15 percent.[25] Figure 19 shows imports, exports, and balances by region.

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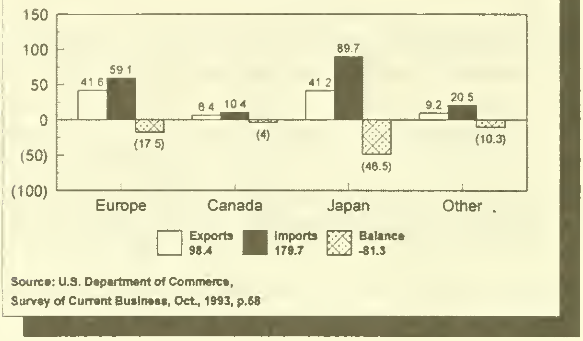
[24] U.S. Department of Commerce, *Survey of Current Business*, October, 1993, p.58.

[25] Europe defined as the UK, France, Germany, the Netherlands, and Switzerland.

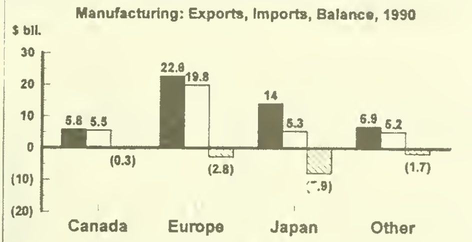
Fig. 18. Trade of Foreign Affiliates in the U.S. 1991



The patterns in manufacturing (Fig. 19) are quite similar, although Europe accounts for a larger share of both imports and exports. Japanese-owned firms account for 64 percent of the total trade deficit stemming from foreign investment in the manufacturing sector.[26]

[26]This picture is somewhat misleading, as many imports -- especially from Japan -- are channeled through wholesalers who count as direct investment in the United States, but who really do little more than trans-ship finished imports.

Fig. 19. Trade of Foreign Affiliates in the U.S.



Source: U.S. Department of Commerce, Survey of Current Business, July, 1993, Tables 6-3, 6-6

Looking only at the export side, European investment in manufacturing accounts for 70 percent of the total, or 46 percent of U.S. exports associated with FDI; Japanese firms account for only 12 percent of total FDI in manufacturing, but 28 percent of the related exports. Explanations for these differences are not immediately apparent, but they do suggest that Japanese investments are not, as myth might have it, weak sources of U.S. exports, at least in manufacturing.

Taxes

All multinational corporations -- U.S.- and foreign-owned -- have the opportunity to reduce their taxes either through paper transactions or by managing the physical flow of production. As a result, multinationals as a whole tend to pay less taxes than large firms without substantial foreign operations. In the case of European-owned firms, though, the impact is surprisingly small. All U.S.-owned firms paid an effective corporate income tax rate of 1.1 percent on their revenues in 1990. European-owned firms paid 1.0 percent, while Asian firms paid less than a tenth of that -- just under 0.1

percent (firms from America's partners in the North American Free Trade Agreement, Canada and Mexico, paid 0.4 percent).[27]

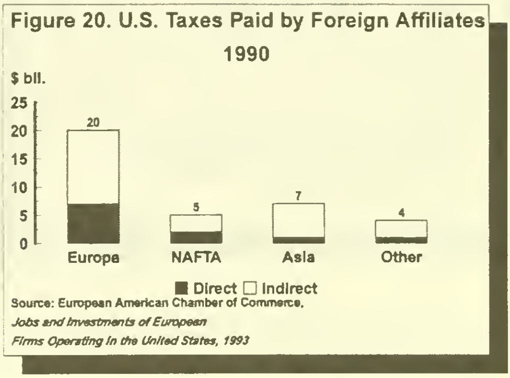


Figure 20. U.S. Taxes Paid by Foreign Affiliates 1990

Source: European American Chamber of Commerce, *Jobs and Investments of European Firms Operating in the United States, 1993*

Different tax rates lead to major differences in payments. The $7 billion paid by European-owned firms for corporate income taxes in 1990 was more than 70 times the amount paid by Asian firms, on revenues that were less than 6 times larger. Indirect taxes tell a rather less extreme story, as they are much harder to evade or avoid legally. In 1993, European firms paid $13 billion in indirect taxes, more than half of all indirect taxes paid by foreign-owned firms, and roughly in line with the European share of overall FDI into the United States.

Trends in foreign direct investment

With FDI, as with trade, straight-line extrapolation does not always lead to a plausible future. The most important recent development -- the massive

[27] *Jobs and Investments of European Firms Operating in the United States, op.cit* p.46

increase in Japan's U.S. FDI position during the 1980s -- was fueled by a number of factors, several of which may not be repeated. These include:

- ***Heavy overextension of the financial sector in Japan*** (the "bubble economy"), which provided massive liquidity to underpin foreign investment. The bubble economy has now burst;

- ***The relatively closed nature of other Asian markets,*** which diverted Japanese direct investment toward Europe and the United States. China and other Asian markets are now opening to Japanese firms;

- ***Industry-specific needs,*** as in the auto industry (a big source of Japanese FDI), where protectionist measures to support U.S.-based auto manufacturing encouraged much FDI, but where Japanese firms have now completed their major plant expansions in the United States and are in some cases retrenching;

- ***A belief that the United States would remain the economic center*** of the industrialized world, and a fear that the United States might turn protectionist under a Democratic administration. Neither are such powerful beliefs any longer; and

- ***A belief that investment in the United States would provide insurance against regional market downturns and a good rate of return.*** In the event, the latter at least has proved to be a disastrous assumption, especially with the steady decline in the yen value of the dollar.

In the near future, moreover continuing international pressure on Japan may force their trade surpluses to decrease. This development would directly reduce the pressure to invest abroad, directly or indirectly. Other Asian countries are unlikely to step into the gap, especially while Asian markets are booming, although there may be a substantial inflow from Hong Kong as the 1997 transition to Chinese rule draws closer.

In addition, some of the highest profile Asian investors are now having second thoughts about America: Japanese firms are trying very hard to clean up their balance sheets in U.S. real estate, even if this means taking huge losses, while Sony is apparently seeking ways to reduce its holdings in Columbia pictures.

For Europe, circumstances are again rather different:

- ***European manufacturers, especially from Germany, have come to see the United States as a low-cost, high quality, production base.*** The recent decisions by BMW and Mercedes-Benz to move production outside Germany for the first time and into the United States underline the weight of this new trend;

- ***European capital flows are internationalizing*** under the liberalizing effect of the Single Market program, and these flows are increasingly seeking off-shore harbors; and

- ***Asian markets are not seen in Europe as stable or easily penetrated,*** while the United States remains highly attractive.

Straight-line extrapolations would suggest that Japanese FDI in the United States will continue to expand fast. A more plausible scenario, however, is that the Japanese share of U.S. FDI has already topped out, and may even start to decline given greater opportunities closer to home. And although non-Japanese investment from Asia is likely to expand as other countries in the region become richer, that expansion will come from a very small base (around $2 billion in 1991). It will probably not reach anything like the level attained by Japanese FDI in the late 1980s, at least for the foreseeable future.

Conclusions

Despite the highly publicized inflow of Japanese FDI into the United States in the second half of the 1980s, European FDI still dominates both overall and

particularly in manufacturing. European firms retain a dominant share of the assets, sales, jobs, taxes, and research and development -- as Section IV will show -- related to FDI in the United States.

This balance is not likely to change in the near future. In fact, inflows from Japan are already declining sharply, and it seems most likely that the golden age of Japanese FDI in the United States is already over.

In the medium term, Europe will remain the most important source of foreign investment in the U.S. economy. This, in turn, means that European firms investing in the United States will continue to act as a substantial source of jobs, taxes, and other benefits.

III. U.S. Investment Abroad

U.S. investment abroad is a crucial element in the U.S. economy for three main reasons.

- *The direct flow of profits and revenues is substantial.* Both have in the past moved countercyclically with the U.S. economy, flowing in at times when U.S. profits were weak. Certain firms -- notably Ford and General Motors -- have been rescued by inflows from Europe when North American markets were unprofitable and liquidity pressures were severe. In all, U.S. overseas investment currently generates more than $1.2 trillion in sales revenue annually -- with $734 billion of that coming from Europe.

- *Trade does follow the corporate flag,* and a strong U.S. presence on the ground is a crucial contribution to U.S. exports. Two-thirds of the flow of goods across the Atlantic is accounted for by trade between multinational corporations; one-third of all transatlantic trade is trade within the same company. By contrast, limited presence on the ground in certain countries, notably Japan, has been closely linked to relatively low levels of U.S. exports.

- *Access to foreign technologies and suppliers* has become extremely important for U.S. companies, as competing foreign firms have caught and sometimes passed the United States in a range of technologies. A direct presence is often necessary both to identify the sources of new technologies (often small and domestically oriented firms) and to build the relationships necessary to access those technologies. Conversely, the absence of a strong presence on the ground has made the acquisition of such technologies and suppliers more difficult.

For all of these reasons, it is strategically important for U.S. firms to invest globally, especially in high tech sectors. But different governments treat foreign firms quite differently.

In Europe, U.S. investors face a considerable range of treatment. Officially, the European Union has placed language in its treaties that guarantees the right of establishment, and the equal rights of all companies registered within the physical boundaries of the Union -- language which covers U.S. investors. The rights are backed by legal recourse, although legal proceedings are at least as slow and cumbersome in Europe as they are in the United States.

In addition, a number of European countries are moving toward a model of corporate financing and government that more closely approximates the market-driven, shareholder based model prevalent in the United States and United Kingdom. Privatization in particular is now sweeping through almost all European countries. Opportunities to buy into local firms are therefore on the rise, although it will be years or even decades before complex cross-share holding and bank-holding arrangements, such as those common in Germany, unwind.[28]

In practice, foreign-owned firms clearly face a range of national policies in Europe. Britain in the main does not distinguish between foreign and domestic firms; France, on the other hand, has traditionally been highly suspicious of U.S. capital (indeed of foreign capital generally), and has only recently become somewhat more hospitable to foreign investment. Germany remains officially open but at the same time a difficult market because of traditional share holding patterns. Other European countries fall somewhere between the British and German cases. Overall, though, U.S. firms have found it possible to invest substantially in Europe, accumulating a stock of investment amounting to nearly $240 billion.

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[28]And there are of course many who would argue that the German model should be imitated in the United States, rather than dismantled. See Michael Porter, *Capital Choices* (Washington, D.C.: Council on Competitiveness), 1992.

The story in Asia is quite different. U.S. firms have found it much harder to invest in Japan, and also -- to varying degrees -- in other countries in the region. According to the Organization for Economic Cooperation and Development (OECD), official barriers to inward FDI in the region are substantial.[29] Yet even these official barriers are less important than the unofficial barriers posed by the structure of financial and industrial holdings.

These factors are reflected in the distribution of U.S. direct investment abroad. Europe's $240 billion represents 49.2 percent of the total, while Asia, including Japan, accounts for much less -- $78 billion, or 16.3 percent, as shown in Figure 21:

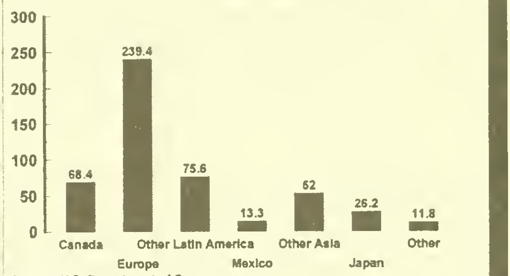
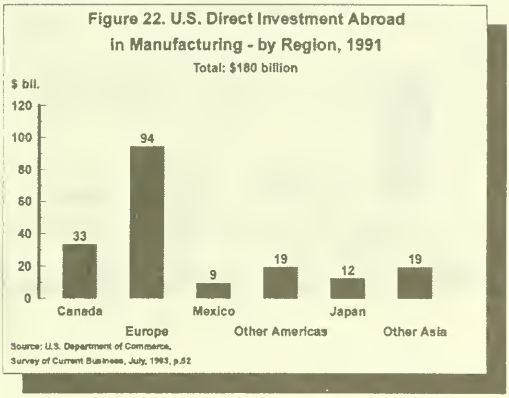


Figure 21. U.S. Direct Investment Abroad, 1992
Total: $486 billion

Source: U.S. Department of Commerce, Survey of Current Business, July, 1993, p.121

These patterns are also reflected in the data for U.S. investment in manufacturing operations abroad, depicted in Figure 22:

[29]*International Direct Investment: Policies and Trends in the 1980s* (Paris: OECD), 1992.



Given the crucial importance of Japan in manufacturing industries, especially in sectors where access to leading-edge components heavily influences downstream competitiveness, this investment short-fall presents a major potential problem for U.S. firms and U.S. policy.[30] That problem is reflected most clearly in the ratio of inward to outward investment, where Japan is once again an extreme outlier, as Figure 23 shows:

[30]See W. Sandoltz et.al., *The Highest Stakes: The Economic Foundations of the Next Security System* (New York: Oxford University Press), 1992.

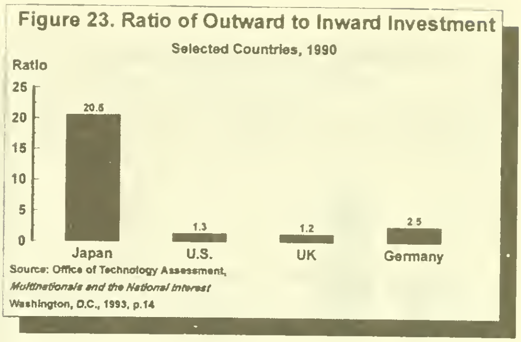


Figure 23. Ratio of Outward to Inward Investment

These patterns are reflected in the data for net income from U.S. subsidiaries abroad. In 1990, European affiliates produced net income of $49 billion, while those in Asia produced $14.7 billion. On a dollar investment basis, European operations produced $0.22 per $1 of investment; Asia produced $0.19. Thus European operations are on this basis about 16 percent more productive.[31]

Trade

U.S. affiliates operating in Europe generated more than $32 billion in U.S. exports in 1990, while at the same time maintaining a significant trade surplus of around $16 billion.[32] In 1991, this figure rose to $20 billion. Rather surprisingly, although trade does normally follow the corporate flag, U.S. affiliates operating in both Japan and Asia as a whole generated a U.S. trade deficit ($7.5 billion in 1990, and $6 billion in 1991 -- see Figure 24).

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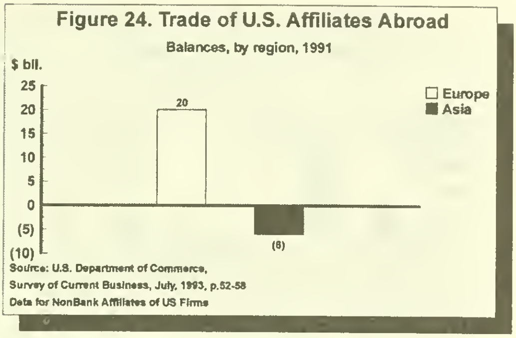
[31] U.S. Department of Commerce, *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates - Revised 1990 Estimates* (Washington, D.C.: U.S. Department of Commerce), July, 1993.

[32] *Ibid.*, Table II E. 7



The main point here, once again, is not the balance in Asia, but the extremely positive relationship with Europe. Even for those concerned that U.S. investment abroad reflects a drain on U.S. capital, investments in Europe clearly produce a substantial direct return in the form of U.S. jobs.

Majority-owned U.S. affiliates abroad (MOFAs)

All the FDI data presented so far for outward U.S. investment cover affiliates in which U.S. firms have a stake of at least 10 percent -- the standard statistical benchmark for FDI. [33]

Yet, the Bureau of Economic Analysis also maintains a database of U.S. affiliates abroad where U.S. interests are at least 50 percent (known as majority-owned foreign affiliates, or MOFAs). The assets of MOFAs are shown in Figure 25.

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[33]This is also the benchmark used by the Organization for Economic Cooperation and Development (OECD).

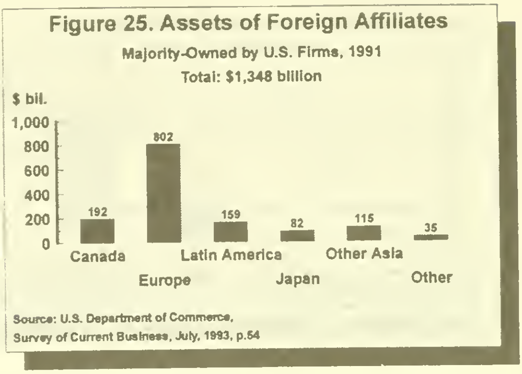


Figure 25. Assets of Foreign Affiliates
Majority-Owned by U.S. Firms, 1991
Total: $1,348 billion

Source: U.S. Department of Commerce, Survey of Current Business, July, 1993, p.54

These data suggest that as U.S. firms venture abroad, they tend to take a majority stake much more often in Europe than in the rest of the world. The following table shows this to be the case. The data for Asia -- and for Japan in particular -- support the argument that the structure of Japanese capital does not encourage such an approach.

Table 1. Majority Ownership and U.S. Investment Abroad

	Europe	*Asia (except Australia)*	*Japan*
Total U.S. Assets	$839 bn	$239.5 bn	$155.0bn
U.S. MOFA Assets	$740 bn	$143.5 percent	$61.4bn
MOFA Assets as percent of Total Assets	88%	59.9%	39.6%

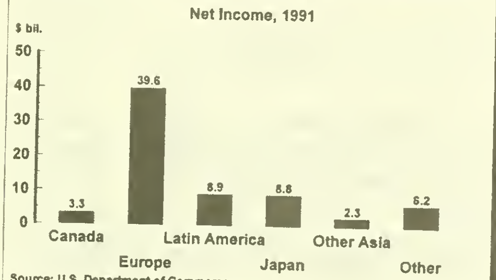
Source: United States Department of Commerce, *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates -- Revised 1990 Estimates*, July, 1993.

Do these difference matter? It is certainly plausible to argue that the European case approximates the "neutral" case and reflects the real desires of U.S. corporations for a majority or minority presence. There is certainly

plenty of anecdotal evidence that U.S. firms investing abroad may be pressured to set up joint ventures, as they are in some parts of Asia today and have been in many parts of Europe in the past. These arrangements can have significant effects on the transfer of technology over the long run, and on both the opportunities open to U.S. corporations, as well as the profits they might reap from their activities abroad.

MOFA assets are generally very productive. In 1991, they accounted for substantial amounts of net income for U.S. parents, and European MOFAs accounted for almost $40 billion in net income, as Figure 26 shows:

Figure 26. U.S. Majority-Owned Affiliates



Source: U.S. Department of Commerce, Survey of Current Business, July, 1993, p.54

MOFAs also have a substantial impact on U.S. trade flows. In Europe, MOFAs have generated hefty U.S. trade surpluses -- $20 billion, on the basis of $35 billion in MOFA exports in 1991 (see Figure 27). These MOFA exports to Europe account for around 8 percent of U.S. global exports.

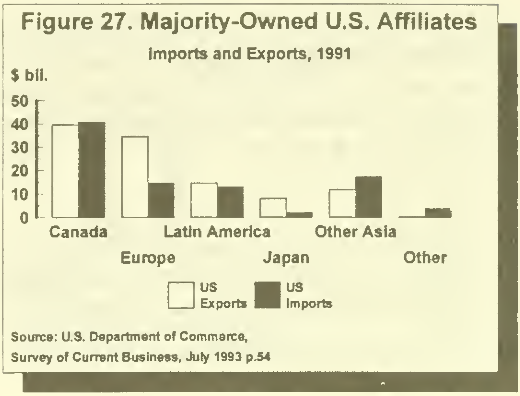


Figure 27. Majority-Owned U.S. Affiliates
Imports and Exports, 1991

Source: U.S. Department of Commerce, Survey of Current Business, July 1993 p.54

Trends in U.S. direct investment abroad

With Europe still in recession and the late 1980s period of "Euro-phoria" clearly over, flows of U.S. direct investment into Europe have slowed somewhat. Partly compensating for this trend has been the continuing reinvestment of European earnings in European operations by U.S. corporations. Yet the apparent attractiveness of Europe has nonetheless declined, at least in the short term.

At the same time, some have argued that Japan is changing, and that Japanese barriers to foreign investment are declining. Moreover, as the Asian boom continues, the region's attractiveness for U.S. corporations is likely to increase -- again, at least in the short run. With major corporations like General Electric claiming to expect a rapidly growing share of their revenues to come from Asia, the tone in the business community is strongly oriented toward more Asian investments.[34]

[34]Jim Hoagland "Latest Trade Darling" *The Washington Post* March 24, 1994 p.A29

Yet the apparent strength of these arguments does not hold up under scrutiny even for the present and recent past, let alone the future. Between 1989 and 1992, U.S. direct investment increased by around 30 percent for Europe, and 50 percent for Asia. Because the baselines for the two regions are so different, however, the **additional** investment in Europe over the period was almost equal to almost the **total accumulated stock** of U.S. direct investment in Asia at the beginning of the period, and total additional investments were approximately $50 billion for Europe and $20 billion for Asia (see Fig. 28) .

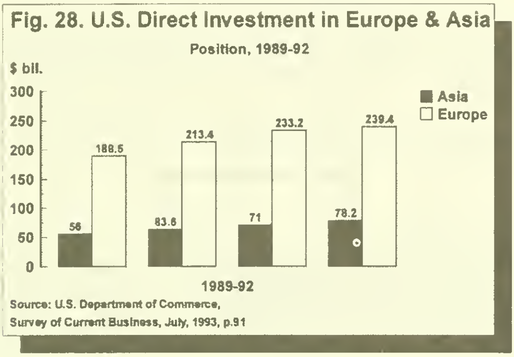


Fig. 28. U.S. Direct Investment in Europe & Asia

In fact, on an annual basis, **the flow of U.S. investment into Europe is still more than twice the flow of U.S. investment into all of Asia** combined, including Japan ($12.5 billion vs. $5 billion). These are very substantial differences.

Conclusions: U.S. direct investment abroad

The United States has been investing in Europe for decades. Henry Ford set up a manufacturing plant in England before World War II, and other big U.S. names (e.g., General Motors, IBM, Woolworth's) have been operating in Europe for many decades.

This history is reflected in the powerful stream of revenues that U.S. corporations still derive from Europe. Table 2 shows European revenues as a percentage of worldwide revenues for the 16 biggest U.S. corporations which break down their revenues geographically. Of the 16 companies, 6 had 30 percent or more of revenues coming from Europe. The average was 27.5 percent:

Table 2. European Revenues as a Percentage of Worldwide Revenues, Selected Major Corporations, 1992

Company	%	*Company*	%
Coca-Cola	30.5	Pepsico	6.1
Philip Morris	29.4	Chevron	28.9
Merck	44.1	GM	21.8
Du Pont	36.7	Mobil	34.6
Procter & Gamble	28.5	Amoco	4.2
Bristol-Myers	28.4	Microsoft	25.7
IBM	40.5	Ford	24.8
Johnson&Johnson	30.9	Intel	25.4

Source: Annual Reports

Naturally, as Asia industrializes, U.S. investment will tend to shift in that direction. Over a long period of time, it is possible, though not perhaps likely, that U.S. investments in Asia will develop the same significance and character that they currently have in Europe. For the time being, however, there are real and important differences between the two regions for U.S. investors. Among the most important conclusions to be drawn from this section are:

- *U.S. investment in Europe dwarfs U.S. investment in Asia,* and will continue to do so for many years to come;

- *U.S. investment flows into Europe are still more than twice those into Asia;*

- *U.S. affiliates in Europe have revenues of more than $800 billion annually,* equal to 13 percent of U.S. GDP. A selection of Fortune 50 firms revealed that on average they received 27.5 percent of their worldwide revenues from Europe in the 1989-92.

- *Profit flows from Europe are higher than they are from Asia,* even per invested dollar; and

- *U.S. investment in Europe has more favorable implications for U.S. trade than similar investments in Asia.*

In short, despite all the excitement about the potential of U.S. investment in Asia, and the likely increase of U.S. investment flows into the region, the United States has a huge existing investment in Europe, and Asian figures will not match these totals in either quantity or quality for a very long time.

IV. TECHNOLOGY

Technology now plays a powerful role in international competitiveness, especially in the industrialized world. The comfort and wealth of our children will be largely determined by how the United States plays the technology game today.

There are no conclusive comprehensive indicators of international technology flows. Collectively, however, the available data most likely capture something of the real state of play. Aside from international technology agreements and trade patterns, there are four main areas worth analyzing:

- ***The level of research and development expenditures by foreign firms in the United States.*** This can be taken to indicate an expansion of U.S.-based technology capabilities;

- ***Royalties and licensing payments from affiliates to foreign parents,*** which indicate technology acquisition and inward technology transfer;

- ***Technology and national security,*** and the targeted acquisition of high tech firms and workers in the United States;

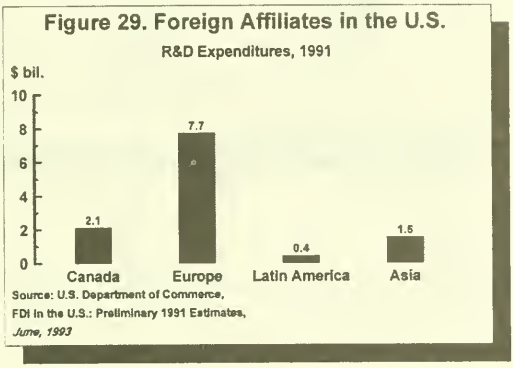
- ***Strategic alliances,*** which are clearly becoming a key element in the strategies of high tech firms.

R&D expenditures

Foreign investors in the U.S. economy already play a significant role in developing the U.S. technology base. And their expenditures also reflect the

extent to which foreign firms are fully integrating themselves into the U.S. economy, as R&D is usually one of the last functions to be transferred from the home country.

In 1991, European firms spent $7.7 billion on R&D in the United States, accounting for 65 percent of total R&D by foreign-owned firms. Asian firms, by contrast, spent just $1.5 billion (see Fig. 29).[35] Spending by European-owned firms amounts to about 5 percent of total U.S. R&D spending, and about 10 percent of R&D spending in the civilian sector.



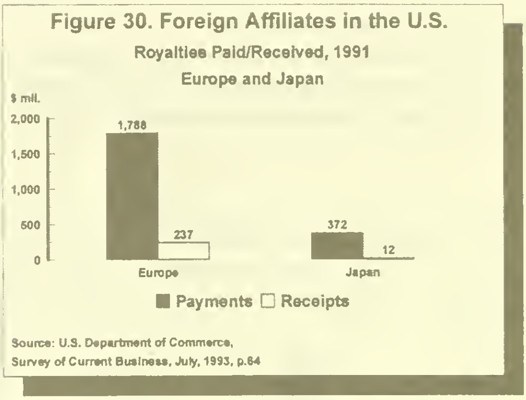
On a dollar-invested basis, European firms spent 3.1 cents per dollar on R&D in the United States; Asian firms spent less than half that much -- 1.4 cents.

Royalties

Royalties are an indirect measure of technology transfer. With the growth of foreign investment in the United States, royalty payments and net receipts

[35] *Jobs and Investments of European Firms Operating in the United States, op.cit* p.57

with their parent companies offer an important window into the related transfer of technology into the United States.



For both Europe and Japan, there is a big imbalance in favor of payments made by U.S.-based subsidiaries to foreign parent companies, which indicates the net provision of technology to the United States. European firms paid more than $1.7 billion in 1991 and $2.1 billion in 1992 to acquire technology from their parents.

Once again, on a dollar invested basis, European affiliates had net inward technology transfers equivalent in 1991 to 0.6 cents per dollar; Japanese firms had less than 0.4 cents.

Technology and security

Congress has recently become concerned about foreign firms using the relative openness of the U.S. economy in ways that are not reciprocated. This issue has also been raised by a number of provocative books, notably works

by Susan and Martin Tolchin, and may be especially important in relation to high technology companies, some of which play an important role in U.S. national security.[36]

The view of the military -- and now the view of the Clinton administration -- is that maintaining completely reliable sources of supply for crucial military inputs is a central goal of national security. These views underpin the new stress on support for dual-use technologies. The administration also recognizes that in many areas civilian technology now leads military technology; hence the health of the civilian technology base has direct security implications.[37]

These views raise some important questions about the broad pattern of technology acquisition by Japanese companies. Quite naturally, and entirely legitimately, Japanese firms have focused on the small, highly innovative firms that the U.S. financial system often denies sufficient working capital -- particularly the mezzanine financing needed to move from development into full-scale production. Large Japanese firms with deep pockets and long time horizons are particularly well placed to work with such firms, taking a large financial stake in exchange for technology access. The situation is summarized in Table 3, drawn from a database maintained at the Economic Strategy Institute:

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[36]See, for example, Martin and Susan Tolchin, *Buying Into America: How Foreign Money is Changing the Face of Our Nation* (New York: Times Books), 1988; and *Selling Our Security: The Erosion of America's Assets* (New York: Alfred A. Knopf), 1992.

[37]*Technology for America's Economic Growth, a New Direction to Build Economic Strength,* President William J. Clinton and Vice President Albert Gore Jr., February 1993

Table 3. Foreign Acquisitions of U.S. High Technology Companies By Industry and by Country, Oct. 1988 - March 1993

	Materials	Aerosp	Chemicals	Computers	Electronics	Semi Equip	Semicond	Telecoms	Biotech	Other	Total
Japan	42	18	25	108	36	34	53	32	27	62	437
UK	12	6	7	14	14	1	2	13	7	6	82
France	3	5	11	10	3	2	1	5	2	6	49
Germany	0	1	6	1	3	1	3	6	6	2	29
Canada	1	3	3	7	2	0	1	2	0	0	19
Switzerland	1	0	1	3	0	1	0	2	5	1	14
Taiwan	1	0	0	8	0	0	2	1	0	0	12
Australia	2	0	0	1	1	1	0	2	1	0	8
S Korea	0	0	0	4	1	0	2	0	0	0	7
Netherlands	1	0	2	2	1	0	0	0	0	1	7
Totals	**70**	**34**	**61**	**171**	**71**	**43**	**65**	**69**	**55**	**83**	**722**

The data indicate that Japanese firms accounted for more than 60 percent of all high tech acquisitions in the United States during this period, and Asian firms for more than 63 percent. This is more than four times the Asian share of FDI in manufacturing (14 percent).

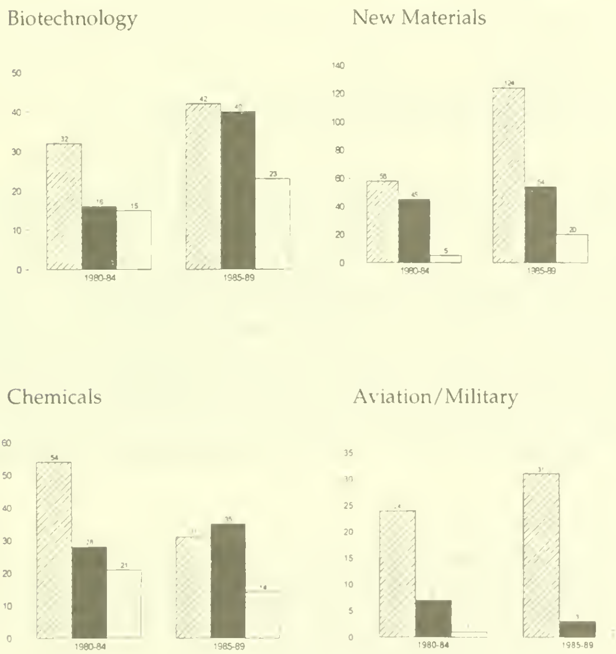
Clearly, the acquisition of small high tech firms has become a specialty of Japanese firms. The question is whether these activities enhance or erode U.S. economic strength and U.S. security, given that U.S. firms cannot operate in a similar way in Japan. That question remains open.

It is critical to note, however, that the activities of European governments and firms are not of particular concern in this area. The five most active European countries have accounted for only 171 acquisitions during the period surveyed. That is 24 percent of the total, or just over one-third of the level of European investment in U.S. manufacturing (70 percent). And as we have already seen, European countries are also much more open to U.S. direct investment abroad, including the purchase of their own domestic high tech firms by U.S. corporations.

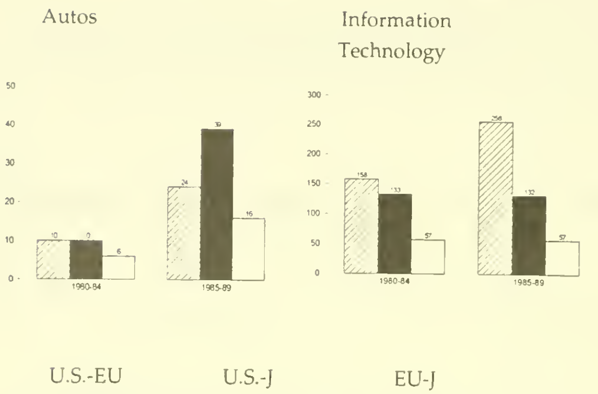
Technology and U.S. firms abroad: strategic alliances

The past 20 years have been marked by a rapid increase in the number of international corporate strategic alliances. Here, as elsewhere, the newspaper headlines would suggest that U.S. firms have been overwhelmingly interested in forming alliances with Japanese firms. Yet the following charts show the data for a range of industries, between 1980 and 1984 and 1985 and 1989:

Figure 31: International Corporate Strategic Alliances in Selected Sectors, 1980-84 and 1985-89



North Atlantic Research, Inc.   Economic Strategy Institute



Source: MERIT; Office of Technology Assessment

Two trends are apparent from the data. First, in most industries, most U.S. alliances have historically been with European firms, not Asian ones. Second, although this pattern is starting to change, it is changing surprisingly slowly. The most recent data still show a U.S. tilt toward European alliances. Overall, U.S.-EU alliances have fallen only slightly as a share of total international corporate strategic alliances. They still account for 61 percent of the total, as opposed to 32 percent for U.S.-Japan, and 14 percent for EU-Japan.[38] Of course, the MERIT database is not completely current; nor does it include the obviously growing number of U.S. alliances with non-Japanese firms in Asia.

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[38]The MERIT database, maintained by the Dutch national university system, is the best of its kind in the world. Yet, it does not track alliances by size or value; it relies (naturally) on published reports; and it may have a Eurocentric bias, although it is designed to avoid that problem. In short, it is the best available source of quantitative data, but may be missing a considerable amount of information.

Conclusions

Alliances are also made for many reasons, not least to secure help in cracking foreign markets. They may therefore indicate the existence of negative factors in an economic relationship as well as positive ones.

Still, in technology, as elsewhere, the ties between the United States and Europe are much stronger than they appear. They can crudely be captured in the following table, which illustrates U.S. technology links with Europe and Asia in several dimensions:

Table 4. Indicators for International Technology Flows

	Europe	*Asia*
Annual R&D expenditures in U.S. - percentage of total investment	3.1	1.4
Net royalties - percentage of total investment	0.6	0.4**
Percent share of number of high tech acquisitions in the U.S. by all foreign investors 1988-93	24	63
Percent share of international strategic alliances with U.S. partners, 1985-89	54	32

** Japan only

V. Conclusions

In each of the four dimensions, the link between Europe and the United States is central to U.S. economic relationships. In most areas, relations with Europe are much more important quantitatively than are similar U.S. relations with Asia. The evidence strongly suggests that this will remain true well into the next century.

Moreover, it is the Europeans who share most strongly U.S. views about the future of the world economic order. Although there are clear differences between American capitalism and European capitalism, they are dwarfed in comparison with the gulf existing across the Pacific. On a number of economic issues central to the next decade and the next century -- trade law, competition policy, labor law -- U.S. interests and those of the Europeans are tightly aligned.

From this analysis flow some important policy prescriptions. First, it is crucial not to mistake policy differences for conflicts over principle. The United States fundamentally agrees with the Europeans on most major issues concerning the organization of the international economic order.

Second, if the United States is to influence significantly the rapidly emerging new global economy, it will need allies. Many of these allies are to be found within Europe.

Third, the Europeans take U.S. works and U.S. actions seriously. Words said at conferences in Seattle and Seoul are read carefully in Bonn and Barcelona. It is unwise to push Europe into considering a future without close links to the U.S. In particular, the notion of the United States playing an Asian card against Europe should be buried.

Finally, both Europe and the United States need to consider new ways to support and manage joint interests. Currently, there are serious policy dislocations across the Atlantic and insufficient mechanisms for integrating the needs of the public and private sectors. New channels of communication inside and especially outside government are clearly needed.

Two specific sets of steps should be taken.

First, North America and Europe should open exploratory discussions aimed at broadening and deepening economic relations among those countries fully committed to market-based economic systems. Although talks would begin around a North American-European core (possibly building on current, low-level U.S.-European Union discussions of regulatory harmonization) their scope would not be limited by geography. Non-Atlantic countries that would be excellent early candidates for inclusion would be Chile and Singapore. Moreover, participation -- and the benefits of freer trade, investment, and technology flows -- would be open to countries willing to conform with the group's core principles and practices.

These discussions would encourage the world's most market-oriented countries to resolve their remaining differences not only on international economic policy but on those domestic issues that bear heavily on international commerce, such as labor policy, competition policy, and environmental and other forms of non-economic regulation. It would also offer an opportunity to develop more strategic and longer-term views of the world economy, while allowing these countries to work more closely together to address the many difficult domestic problems that have emerged in a world of rapidly accelerating economic, technological, and social change.

Such discussions should not be seen as a challenge or threat either to the new World Trade Organization or to any less market-oriented economy. The former should simply be seen as a platform from which like-minded countries can go further in integrating their economies on terms that they find mutually acceptable; the latter would simply find further encouragement to move in directions that both the United States and European Union would applaud.

These discussions would, in short, start the United States and Europe down the path toward an economic parallel to NATO. The latter has provided a forum for the development of joint policies with specific aims and objectives. As US and European concerns shift from military security to economic security, it is equally important to develop a similar forum for economic issues, both international and domestic. It is the continuing absence of such a forum which has placed the spotlight squarely on US-EU quarrels in recent years, rather than on shared practices and mutual interests and objectives.

Second, as this effort proceeds, business leaders on both sides of the Atlantic should set up a forum through which they can communicate their views to their governments. Businesses around the Pacific Basin have benefited from the creation of the Pacific Basin Economic Council, which serves as a private-sector voice and promotes business interests and expanded trade and commerce among North America, Pacific Latin America, East and Southeast Asia, and Australasia. Businesses in North America and Europe could secure the same benefits by creating an Atlantic Basin Economic Council.

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